92-225

No. _____

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1992

FIRST FIDELITY BANK, N.A., NEW JERSEY

Petitioner,

v.

THEODORE RUDBART, NATALIE RUDBART, BEVERLY LITOFF, BENJAMIN WELTMAN, MADELINE OKIN FOR HERSELF AND ON BEHALF OF ALL OTHER PERSONS SIMILARLY SITUATED, AND NORTH JERSEY DISTRICT WATER SUPPLY COMMISSION,

Respondents.

Petition For A Writ of Certiorari To The Supreme Court Of The State Of New Jersey

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. The National Bank Act and the Comptroller of the Currency's regulations require a separation of function between trust and other departments of a national bank by a "Chinese Wall". Is the New Jersey Supreme Court decision below, which requires extensive coordination and communication between trust and other departments of a national bank, contrary to these provisions and void under the supremacy clause?

2. Did the New Jersey Supreme Court deny *res judicata* effect to a prior federal judgment against the same plaintiff class in favor of the same defendants when it held a national bank liable for breach of fiduciary duty in a later state class action?

3. Did the New Jersey Supreme Court deny petitioner due process in adjudicating a question neither briefed nor argued to it and in assuming certain facts essential to its decision absent any evidence in the record?

PARTIES

All parties are listed in the caption.

Petitioner is a wholly owned subsidiary of First Fidelity Incorporated which itself is a wholly owned subsidiary of First Fidelity Bancorporation, its only publicly owned affiliate.

Petitioner has the following non-wholly owned subsidiaries: Allied International Bancorp, Inc., Fawn Run, 500 International Drive and T. Towers A. C., Inc.

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OPINIONS BELOW

The full text of the New Jersey Supreme Court opinion is reported at 127 N.J. 344, 605 A.2d 681 (1992) and is reprinted as Appendix A. The Appellate Division's decision, 238 N.J.Super. 41, 568 A.2d 1213 (App. Div. 1990) is Appendix B. The Superior Court, Law Division's unreported trial court opinion is Appendix C.

JURISDICTION

Jurisdiction of this Court is predicated on the order entered by the New Jersey Supreme Court on April 27, 1992. No motion seeking rehearing was filed. Certiorari is sought pursuant to 28 U.S.C. § 1257(a).[1]

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

This case involves the supremacy clause (Art. VI, cl. 2) and the due process clause of section one of the fourteenth amendment to the United States Constitution, the trust powers provisions of the National Bank Act, 12

[1] In *Cox Broadcasting Corporation v. Cohn*, 420 U.S. 469, 476 (1975) this Court identified four types of finality for purposes of this statute. Three apply here. The first is where the federal issues are conclusive. The second is where the federal issues have been finally decided by the state's highest court and will survive. The fourth identified in *Cox* is where the decision will seriously erode federal policy.

U.S.C. § 92a, and certain of the Comptroller of the Currency's regulations pursuant to the National Bank Act, 12 C.F.R. Part 9. The relevant portions of the constitutional provisions are set forth in Appendix D; the statutory provisions in Appendix E; and the regulations in Appendix F.

STATEMENT OF THE CASE

In 1984, the North Jersey District Water Supply Commission, a New Jersey governmental authority, issued three year Notes. The Notes were subject to early redemption after two years, at a premium. The Notes were registered, and interest checks mailed semi-annually to the holders. The Resolution governing the Notes, however, provided for notice of early redemption to be published in newspapers rather than mailed to noteholders.

Petitioner First Fidelity Bank is a national bank chartered by the Comptroller of the Currency under the National Bank Act. The Comptroller has granted it trust powers. It is the largest bank in New Jersey and has the largest trust department in the state. It was an underwriter of the Notes and was Trustee under the Resolution.

On June 23, 1986, the Notes were called for early redemption. The trust department gave notice to all Note holders by publication in conformity with the Resolution. The investment department gave oral or mail notice to investors to whom it had sold the notes, as is its practice and is common in the securities business. It did this

without any prompting or other communication from the trust department.[2] Some Note holders missed the published notice, and discovered the call when they did not receive their December 15, 1986, interest check.

Class actions were begun in federal and state court. The federal action asserted claims for violation of the federal securities laws, and other counts it described as pendant state law claims, including breach of fiduciary duty claims. Discovery was conducted jointly in the two cases. The District Court granted the Bank summary judgment on the securities count after the completion of discovery. The District Court found that the method of giving notice of redemption and the termination of interest payments on the redemption date were adequately disclosed. It dismissed the pendant state law claims for lack of jurisdiction, *Ellovich v. First Fidelity Bank*, No. 87-650 (D.N.J. Mar. 2, 1988) (this decision is reprinted in Appendix G). The Third Circuit unanimously affirmed, without opinion. 862 F.2d 307 (3d Cir. 1988).

The state court action asserted theories of unjust enrichment and breach of fiduciary duty. The trial court

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[2] The Supreme Court plurality opinion (127 N.J. at 364, 605 A.2d at 691) says the head of the Bank's corporate trust department was aware of the written notice given by the investment department to its customers. It does not say *when* he became aware. His deposition (at 123-24), provided to the Supreme Court, makes quite clear that he learned in December, 1986 or January, 1987 for the first time what the investment department had done.

granted the Bank summary judgment after the District Court decision.

The Appellate Division unanimously reversed, holding that all securities are contracts of adhesion subject to subsequent judicial review for fairness. 238 N.J. Super. 41, 568 A.2d 1213 (1990). As the New Jersey Supreme Court later acknowledged, this unprecedented holding had been a one sentence, almost throw-away, argument in plaintiffs' appellate brief.

Because of the potentially devastating effect this holding could have on the national securities markets, the Bank (and the issuer) sought and were granted review in the New Jersey Supreme Court. 122 N.J. 137, 584 A.2d 210 (1990).

On April 27, 1992 the state Supreme Court, by a 5-2 vote, reversed the Appellate Division's holding that securities were subject to subsequent judicial review as contracts of adhesion, 127 N.J. 344, 605 A.2d 681 (1992).

The Supreme Court itself then went on to address an issue that had been neither argued nor specifically briefed before it: whether the conduct of the investment department of the Bank, which had telephoned or mailed notice of early redemption to the list of customers to whom it had sold the Notes, imposed a duty on the trust department to do likewise for all Note holders. The Supreme Court held it did by a 4-3 vote involving four different opinions. It therefore imposed a constructive trust on the Bank for the amount by which the Bank had been unjustly enriched. 127 N.J. at 361, 605 A.2d at 689.

FEDERAL QUESTIONS BELOW

First Fidelity raised each federal question below at several junctures.

The Bank addressed the National Bank Act limitations in the trial court in a supplemental letter brief of September 9, 1988 (Appendix N). The trial court opinion impliedly accepted those limits (Appendix C at A-78). In the state Supreme Court, the Bank's reply brief in support of certification, at 2-3, raised the issue (Appendix O) as did its supplemental letter brief of January 30, 1992, at 2-4 (Appendix L).

The Bank raised the question of the preclusive effect of the prior federal adjudication in the trial court in its brief in support of its cross-motion for summary judgment at 9-12 (Appendix H) and in its reply letter brief of August 25, 1988 at 2-5 (Appendix I). In the Appellate Division, First Fidelity's brief at 14-16 and 24-27 (Appendix J) raised the issue. It was rejected at 238 N.J.Super. 41, 56-57, 568 A.2d 1213, 1221. In the New Jersey Supreme Court, the petition for certification at 16-17 (Appendix K) and the Bank's supplemental letter brief of January 30, 1992, at 2-3 (Appendix L) both addressed the issue.[3]

The due process limitations on adoption by the Supreme Court of an analysis without notice and opportunity to be heard were addressed in First Fidelity's transmittal letter of May 13, 1991, at 2-3 (Appendix M). Because the use of assumptions instead of facts by the Supreme Court was

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[3] In response to a special request from the New Jersey Supreme Court in May, 1991, the briefs that had raised this question in the trial court were directly provided to the Supreme Court as tabs 7 and 12 respectively.

unforeseeable, this issue was not expressly dealt with below. *See Pruneyard Shopping Center v. Robins*, 447 U.S. 74, 85-86 n.9 (1980).

REASONS FOR GRANTING THE WRIT

"Sentence first – verdict afterwards."[4]

That instrumentalist judicial philosophy has permeated the decisions of both New Jersey appellate courts that have considered this case. Instead of the principled decision making that the federal courts and the state trial court applied to this case, both state appellate courts decided some wrong had been done, and then set out to define it.

The New Jersey Supreme Court's approach decided important questions of federal law. Some were decided in a way that conflicts with the applicable decisions of this Court. Others should be, but have not been, settled by this Court.

The New Jersey Supreme Court's decision has three flaws from a federal perspective. First, it ignores important aspects of the National Bank Act and the Comptroller of the Currency's implementing regulations. Second, it does not give adequate deference to a prior federal case involving the same facts. Third, it decides questions that had not been briefed and argued, without evidence, forcing it to resort to assuming facts.

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[4] L. Carroll, *Alice's Adventures in Wonderland*, ch. 12.

Before describing the details of these flaws, we focus on their widespread and systemic significance. The principle of the supremacy of the federal courts, federal legislation and federal regulation is violated by the first and second flaws in the state court's decision. There are about 3,820 national banks in the United States, of which about 1,575 exercise trust powers. New Jersey hosts 51 of the national banks, of which about 20 exercise trust powers. This decision will adversely affect all of the national banks in New Jersey. If left unreversed, the decision will expose all national banks across the country to state adjudications that ignore their federal regulatory obligations. Similar problems will beset federally chartered savings institutions.[5]

State attempts to control nationally chartered banks are not new to this Court's jurisprudence, *see M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819).[6] This Court continually grants certiorari to state courts to review state taxation of national banks.[7] Certiorari to review state

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[5] There are about 3,200 federally chartered thrift institutions in the United States of which 107 are in New Jersey.

[6] It is important for the federal government to regulate national banks. Albert J. Beveridge's classic work, IV *The Life of John Marshall* (1919) describes in Chapter IV, *Financial and Moral Chaos*, the problems the national government tried to remedy by creating the first national bank. Chapter VI describes the decision itself.

[7] *Chase Manhattan Bank, N.A. v. Finance Admin. of City of New York*, 440 U.S. 447 (1979); *Diamond Nat'l Corp. v. State Bd. of Equalization*, 425 U.S. 268 (1976); *First Agricultural Nat'l Bank of*

(Continued on following page)

court decisions on venue of actions involving national banks has been a fertile source for this Court's docket.[8] Application of state usury law to national banks twice came before this Court on certiorari.[9] In *Third Nat'l Bank in Nashville v. Impac Limited, Inc.*, 432 U.S. 312 (1977) this Court affirmed on certiorari a Tennessee Supreme Court decision that state courts could enjoin national bank mortgage foreclosures. In *Franklin Nat'l Bank of Franklin Square v. New York*, 347 U.S. 373 (1954) this Court reversed the New York court's decision that a state statute could prevent a national bank from using the word "savings." Questions of the authority of the Comptroller of the Currency to charter national banks, define their powers, permit branches and consider bank antitrust questions have come before this Court frequently, usually on certiorari.[10] Here the state's attempt to regulate the trust activities of a national bank is likewise worthy of this Court's attention.

(Continued from previous page)

Berkshire Co. v. State Tax Com., 392 U.S. 339 (1968); *Michigan Nat'l Bank v. Michigan*, 365 U.S. 467 (1961); *cf. First Federal Savs. & Loan Assoc. of Boston v. State Tax Com.*, 437 U.S. 255 (1978) (same for federal savings and loan).

[8] *Citizens & Southern Nat'l Bank v. Bougas*, 434 U.S. 35 (1977); *Chase Manhattan Bank v. Sailboat Apartment Corp.*, 429 U.S. 911 (1976); *National Bank of North America v. Associates of Obstetrics & Female Surgery, Inc.*, 425 U.S. 460 (1976); *Michigan Nat'l Bank v. Robertson*, 372 U.S. 591 (1963); *Mercantile Nat'l Bank at Dallas v. Langdeau*, 371 U.S. 555 (1963).

[9] *Deposit Guaranty Nat'l Bank v. Roper*, 445 U.S. 326 (1980); *Marquette Nat'l Bank v. First of Omaha Service Corp.*, 439 U.S. 299 (1978) (certiorari to Minnesota Supreme Court).

[10] We have found about 25 such cases in the last 25 years reviewing the Comptroller's activities.

I.

This Court Should Remedy The Failure Of The State Court To Accord The National Bank Act Due Deference.

First Fidelity Bank, *National Association*, New Jersey, is a national banking association created under the National Bank Act, 12 U.S.C. § 21 *et seq*. When a national bank acts as a trustee, as here, it does so under a grant of fiduciary powers by the Comptroller of the Currency, pursuant to the National Bank Act, 12 U.S.C. § 92a(a).

The decision below conflicts with federal regulation of national banks in three ways. First, the decision is inconsistent with 12 C.F.R. § 9.7(d), which creates a Chinese Wall cutting off the flow of information between a national bank's trust department and the commercial side of the bank. The Wall is required to prevent problems under the federal securities laws, especially those prohibiting insider trading. Second, the decision treats a national bank's separation of its trust department from its commercial departments as a mere administrative convenience. That structure is actually compelled by statute and regulation. Third, it undercuts 12 C.F.R. § 9.10, which addresses a national bank's duty to invest funds awaiting distribution.

A. The Decision Below Breaches The Chinese Wall Required By Federal Law

As required by 12 C.F.R. § 9.7(d):

> Every national bank exercising fiduciary powers shall adopt written policies and procedures to

> ensure that the Federal securities laws are complied with in connection with any decision or recommendation to purchase or sell any security. Such policies and procedures, in particular, shall ensure the national bank trust departments shall not use material inside information in connection with any decision or recommendation to purchase or sell any security.

The Chinese Wall was developed to regulate the flow of information between a bank's fiduciary and commercial departments and to prevent the improper use of material inside information, in violation of securities laws and regulations. *Comptroller's Handbook for Fiduciary Activities* at 72 (1990). "The term 'Chinese Wall' refers to a set of procedures, rules, and, in some cases, physical arrangements which serve to prevent communication of certain kinds of information between departments of banks or even within bank departments." Herzel & Colling, *The Chinese Wall Revisited*, 6 Corp. L. Rev. 116, 119 (1983). Its most common use is to prevent the communication of material inside information to bank officers responsible for making or recommending purchases and sales of securities. The Chinese Wall also applies in other contexts at national banks, such as conflict of interest situations, and in other institutions, such as law firms and investment banks. *See generally* Herzel & Colling, *supra*.

Courts in other jurisdictions have acknowledged the validity of the Chinese Wall and have ruled accordingly. They have dismissed claims of breach of fiduciary duty against pension or ESOP trustee banks for failure to act on information known to the bank as commercial lender. *See Ershick v. United Missouri Bank*, 12 E.B.C. 2323, 1990

U.S. Dist. Lexis 11929 (D. Kan. 1990); *Connell v. Chase Manhattan Bank*, N.Y. Law J., Jan. 15, 1981 at 7, col. 1 (Sup. Ct. N.Y. Co.)

As the Third Circuit noted in *Washington Steel Corp. v. TW Corp.*, 602 F.2d 594, 601 (3d Cir. 1979) in rejecting a request to imply a state common law fiduciary duty for a national bank:

> Given the need for uniform rules in an area so vital to our national economy as banking, any state common law rule we might imply would likely give way to the preemptive force of federal law. *Cf. Clearfield Trust Co. v. United States*, 318 U.S. 363 (1943).

In *Rudbart*, the New Jersey Supreme Court takes exactly the opposite view of the Chinese Wall: instead of respecting the Wall, it belittles it. The Court condemns First Fidelity's trust department for acting differently towards its customers than did its investment department, thus imputing one department's knowledge to the other. In doing so, "the Court does not suggest that Fidelity's investment department used inside information or otherwise acted improperly in notifying its customers of the redemption . . . ." 127 N.J. at 381, 605 A.2d at 700 (Gaulkin, J., dissenting). Rather, the Court totally dismisses the Chinese Wall. As articulated by Judge Petrella, who provided the fourth vote essential to forming a majority, 127 N.J. at 376-377, 605 A.2d 697:

> First Fidelity took the position that the deposition testimony demonstrated that a "Chinese wall" existed between the trust department and the investment department that was kept intact during this transaction. . . . However, it

> was not First Fidelity's trust department that was appointed as trustee, but rather, the bank.
>
> * * *
>
> Although First Fidelity has a trust department, an investment department, and other departments or functions, it was First Fidelity that was appointed trustee, not one of its departments. . . . The bank is charged, or should be charged here, with knowledge of all of the actions of all its departments and subdivisions.

The Court implied a new common law rule with no deference to the preemptive force of federal law. It expected the investment department to tell the trust department what it was doing or the two departments to coordinate their activities regularly.[11] This raises serious questions. For example, if the Bank's investment department recommends to its customers the sale of bonds for which the trust department acts as trustee, must the trust department communicate that recommendation to all bondholders? If the two departments communicate on a regular basis, there is an increased risk that material inside information in the possession of the trust department (for example, details about upcoming redemptions, to which it is often privy) may be communicated in

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[11] As explained in footnote 2 above, contrary to the innuendo in the state Supreme Court decision, here the two departments did not communicate at the time of the redemption. Rather, six months later an internal investigation by the Bank, prompted by complaints from Note holders, revealed the different actions for the first time.

violation of both the federal banking and securities laws. The New Jersey Supreme Court's decision, creating a new common law fiduciary duty for national banks, opens the door to many problems in reconciling the Bank's regulatory obligations to the Comptroller of the Currency and the Securities and Exchange Commission. This Court should address these questions.

B. The Decision Below Prevents The Separation of Trust Functions Required By Federal Law

The decision below treats the separate existence of the Trust Department as a mere administrative or organizational convenience. For example, Judge Petrella states that "[t]he existence of separate divisions for business purposes does not allow [the Bank] to act in a disparate manner when it knows the names and addresses of registered note holders who are both customers and non-customers." 127 N.J. at 377, 605 A.2d at 698.

The Court ignores the federal statutory and regulatory scheme that requires a national bank to separate its trust department from the rest of the bank. The National Bank Act and the Comptroller's regulations are replete with requirements that trust departments must be separate. Paragraph (c) of 12 U.S.C. § 92a requires a national bank exercising trust powers to "segregate all assets held in any fiduciary capacity from the general assets of the bank and [to] keep a separate set of books and records showing in proper detail all transactions engaged in under authority of this section." Paragraph (d) requires a national bank to carry funds deposited or held in trust by it while awaiting investment in a separate account. It also

prohibits the bank from using these funds in the conduct of its business unless it sets aside certain collateral in the trust department. (These sections are reprinted in Appendix E).

The principle of separation has been carried out by the Comptroller in his regulations. In addition to the Chinese Wall provision of 12 C.F.R. § 9.7(d), described above, 12 C.F.R. § 9.8(a) requires a national bank exercising trust powers to keep its fiduciary records separate and distinct from all other records of the bank. Furthermore, 12 C.F.R. § 9.13(a) requires the investments of trust accounts to be kept separate from the assets of the bank. (These regulations are reprinted in Appendix F). Indeed, this need for separation of the trust department has been carried so far as to require a national bank to obtain a separate number for its trust department to use when buying student loans. *See* O.C.C. Trust Interp. No. 192, [1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 84,959.

Thus, unlike an ordinary business corporation which is free to organize itself on product, geographic or some other lines, a national bank is required to have a separate trust department. Judge Petrella and the *per curiam's* treatment of the separation as a mere moving of boxes on an organization chart is wrong under federal law.

C. The Decision Below Fails To Recognize That A National Bank's Duty To Invest Is Fully Regulated By Federal Law

Title 12 C.F.R. § 9.10(a) provides:

> Funds held by a national bank in a fiduciary capacity which are awaiting investment or

> distribution shall not be held uninvested or undistributed any longer than is reasonable for the proper management of the account. Each national bank exercising fiduciary powers shall adopt and follow written policies and procedures intended to ensure that the maximum rate of return available for trust-quality, short-term investments is obtained upon funds so held, consistent with the requirements of the governing instrument and local law. Such policies and procedures shall take into consideration all relevant factors, including but not limited to the anticipated return that could be obtained while the cash remains uninvested or undistributed, the cost of investing such funds, and the anticipated need for the funds.

First Fidelity complied with this regulation, and had no duty to invest the proceeds of the redemption, either under its policy, the Resolution or local law. No one argued that First Fidelity did not follow its policy. It is undisputed that First Fidelity acted in accordance with the Resolution (the governing instrument for these Notes) which specifically provided that the Note holders would not be entitled to interest after the redemption date. Furthermore, local law did not require First Fidelity to invest the redemption proceeds while they were awaiting distribution. While local law, embodied in N.J.S.A. 17:9A-35(D), requires a bank acting in certain fiduciary capacities to sweep funds awaiting investment or distribution into an interest-bearing account, it specifically omits from this requirement a bank acting as trustee for corporate or municipal securities.

While the New Jersey Supreme Court states that it does "not predicate [its] holding on 12 C.F.R. § 9.10 or

N.J.S.A. 17:9A-35(D)", 127 N.J. at 367, 605 A.2d at 693, by misconstruing those provisions it undermines them. Judge Petrella's opinion, which provides the fourth vote needed for a majority, makes this misconstruction clear when he wrongly says (at 127 N.J. at 377, 605 A.2d at 697):

> [First Fidelity] had fiduciary responsibilities under the terms of the resolutions, and those were not negated by federal law or a lesser standard of trusteeship. [FN8]
>
> FN8. This is aside from obligations imposed by law. 12 C.F.R. § 9.10 and N.J.S.A. 17:9A-35(D) appear to assume that unclaimed fiduciary funds are not to be held uninvested longer than reasonably necessary for proper account management. See *supra* at 374 n.6, 605 A.2d at 696 n.6.

This language fails to recognize the explicit exclusion of note trustees from the investment obligation under state law, and the limited duty under federal law.

This Court should grant certiorari as in the cases above at 7-8 to prevent state regulation of national banks that is inconsistent with federal law.

II.

This Court Should Remedy The Failure Of The State Court To Accord The Prior Federal Action Due Deference.

As explained above at 14 the Comptroller of the Currency has adopted 12 C.F.R. § 9.10, entitled "Funds Awaiting Investment or Distribution," in furtherance of the National Bank Act. This section, by its express terms, governs the

duties and responsibilities of a national bank acting as trustee holding unredeemed note funds awaiting distribution.

Thus, because plaintiffs' claim concerns a national bank's duty in these circumstances, it arises under federal law. It is therefore within the jurisdiction of the federal judiciary. *See, e.g., First Nat'l Bank in Plant City, Florida v. Dickinson*, 396 U.S. 122 (1969); *Ramapo Bank v. Camp*, 425 F.2d 333, 345 n.33 (3d Cir.), *cert. denied*, 400 U.S. 828 (1970).

There was a prior litigation arising from the Note redemption in this case brought in federal court by the same class, *Ellovich v. First Fidelity Bank, N.A., New Jersey*, No. 87-650, (D.N.J. Mar. 2, 1988) (Appendix G). Class actions have the same claim and issue preclusion effects (*res judicata* and collateral estoppel) as ordinary suits. *Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356 (1921). The decisions of this Court establish that a state court must accord a prior federal court judgment full preclusive effect. *City of Tacoma v. Taxpayers of Tacoma*, 357 U.S. 320 (1958); *Stoll v. Gottlieb*, 305 U.S. 165 (1938).

The New Jersey Supreme Court recently dealt with the preclusive effect of a prior federal case on a subsequent state action, citing cases from this Court. In *Watkins v. Resorts Int'l Hotel & Casino*, 124 N.J. 398, 591 A.2d 592 (1991) it held (at 124 N.J. 412-13, 591 A.2d 599):

> Claim preclusion applies not only to matters actually determined in an earlier action, but to all relevant matters that could have been so determined. *Angel v. Bullington*, 330 U.S. 183, 192-93 (1947); *Culver v. Insurance Co. of N. Am.*, 115 N.J. 451, 463, 559 A.2d 400 (1989). For the

> purposes of *res judicata*, causes of action are deemed part of a single "claim" if they arise out of the same transaction or occurrence. *Restatement (Second) of Judgments, supra*, § 24. If, under various theories, a litigant seeks to remedy a single wrong, then that litigant should present all theories in the first action. Otherwise, theories not raised will be precluded in a later action. *Angel, supra*, 330 U.S. at 192-93; *Cemer v. Marathon Oil Co.*, 583 F.2d 830, 832 (6th Cir. 1978).

Here the bond redemption challenged in the prior federal *Ellovich* case was the same "transaction" now at issue. Yet the Supreme Court considered on the merits a claim plaintiff could have brought in the federal action because it was a federal question: whether the bank had breached a fiduciary duty owed the plaintiffs. The Supreme Court imposed a constructive *trust*. It did so based on the third count of the complaint, 127 N.J. 344, 362, 605 A.2d 681, 690, which sounded in fiduciary duty. It termed the uncollected proceeds a "trust" fund. 127 N.J. at 363, 605 A.2d at 690. It referred to the Bank as trustee and described its role as fiduciary. 127 N.J. at 365, 605 A.2d at 691. *See also* 127 N.J. at 366, 605 A.2d at 692 ("multi-hatted trustee"). The fourth vote for this result, from Judge Petrella, took the same view. 127 N.J. at 375-76, A.2d at 696-697.

There is federal jurisdiction over the New Jersey Supreme Court's theory of a national bank's duty as trustee with respect to funds awaiting distribution, as shown above. Thus, this fiduciary duty theory could have been but was not raised as a federal question in the first, federal action and therefore was precluded. The New

Jersey Supreme Court deprived the prior federal judgment of its proper *res judicata* effect by its holding.[12]

We do not contend that the federal court's jurisdiction was exclusive of the state courts to hear this claim originally. But once having litigated in federal court, the class must have all of its federal claims adjudicated there or they are barred. *Angel v. Bullington*, 330 U.S. 183, 192-93 (1947).

III.

The New Jersey Supreme Court Denied Due Process By Acting With No Opportunity For The Bank To Be Heard And On No Evidence.

There are two problems with the Supreme Court's decision from a due process perspective: the court decided an issue on which it had not given the parties an adequate opportunity to be heard and it decided the case without evidence.

First, the New Jersey Supreme Court denied the Bank notice and an opportunity to be heard. It granted certification on the contract of adhesion question addressed by the Appellate Division. That was the topic briefed and argued. A year later the Supreme Court invited additional briefing on any issue pleaded below. It ultimately decided the case on a crazy quilt theory sewn from a patchwork of swatches from different counts of the complaint and briefs in the Appellate Division. The Bank never had a chance to be heard on this theory.

---

[12] *Chick Kam Choo v. Exxon Corp.* 486 U.S. 140 (1988) has been read in one case as limiting district court authority to act in these circumstances. If this reading is correct, this Court has a heightened responsibility to remedy the New Jersey Supreme Court's denial of *res judicata* effect.

This Court has observed:

> An essential principle of due process is that a deprivation of life, liberty, or property "be preceded by notice and opportunity for hearing appropriate to the nature of the case." *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950). We have described "the root requirement" of the Due Process Clause as being "that an individual be given an opportunity for a hearing *before* he is deprived of any significant property interest." *Boddie v. Connecticut*, 401 U.S. 371, 379 (1971) (emphasis in original); *see Bell v. Burson*, 402 U.S. 535, 542 (1971).

Cleveland Bd. of Educ. v. Loudermill, 470 U.S. 532, 542 (1985). The state Supreme Court plurality opinion's opening sentence identifies the issues of which parties were given notice (at 127 N.J. 347, 605 A.2d 681):

> We granted certification, 122 N.J. 137 (1990), primarily to consider the contention of First Fidelity Bank, N.A., New Jersey (Fidelity) that "in a published decision without precedent in the United States the Appellate Division had ruled that every investment security, whether a stock, bond, note or in some other form, is a contract of adhesion subjecting every term of the agreement to post hoc review for fairness."

That opinion later says:

> Having disagreed, then, with the Appellate Division's sole basis for its decision, we would ordinarily remand the matter to the Appellate Division for consideration of whether plaintiffs' complaint stated a cause of action for relief on any of the other theories pleaded, *supra* at 351, 605 A.2d 684, such as negligence, conversion, or constructive trust. Because the case is now more than five years old, we believe it best to resolve

> those claims on the record before us. After oral argument, we afforded the parties and the amici the opportunity to file supplemental briefs on any theory of liability or defense previously pleaded.

(127 N.J. at 361, 605 A.2d at 689-690)[13]

The court's own description of the basis of its holding shows that this "opportunity" did not provide the fair notice required by due process of what was afoot:

> Although plaintiffs' Appellate Division brief may inartfully describe their complaint as "establish[ing] a cause of action for conversion," the relief that they plainly sought under the first and third counts of the complaint established the theory of constructive trust as an alternative basis for relief. In their supplemental memorandum, plaintiffs asked the Court as an alternative to the 7⅞ percent interest under the notes, that they be awarded the "interest on such [unredeemed] funds" by virtue of a general duty of a trustee to invest funds of a beneficiary. For while plaintiffs sought to "reform the terms of the notes issued to require notice by mail," they also sought to "impos[e] a constructive trust upon the unclaimed funds with all interest

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[13] Although delay alone can never justify a denial of due process, the delay is principally of the state appellate judiciary's making. The case was fully briefed in the Appellate Division in April 1989. It was decided in January, 1990, nine months later. It was fully briefed in the Supreme Court in October, 1990. It was decided in April 1992, nineteen months later. Thus, for over twenty-eight months, or half its life, it was delayed in the appellate courts awaiting decision.

> accrued thereon." With all of the favorable inferences that we must accord to plaintiffs' proofs, their complaint surely sets forth a claim to at least a partial return of any interest earned on these funds.

Both dissenting opinions describe the effect of this "shot in the dark" invitation from the court coupled with the unforeseeable "favorable" construction of the "inartful" complaint. Judge Gaulkin noted (at 127 N.J. 382, 605 A.2d 700) that "the Court [is] announcing rights and duties the litigants have never argued." Justice Clifford's dissent begins (at 127 N.J. 382, 605 A.2d 700): "On the only issue raised in the petition for certification and addressed at oral argument, the plurality opinion declares that the Appellate Division erred in 'holding that the subject securities constitute a contract of adhesion.' "

To the extent the New Jersey Supreme Court decided an issue without the benefit of the analysis of the parties either in briefs or oral argument, before it or below, it violated the due process clause. In its own decision in *Ford v. Reichert*, 23 N.J. 429, 435, 129 A.2d 439, 442 (1957) the Supreme Court observed:

> In the procedure before us, however, the judicial fundamental of the right to be heard seems to have been completely forgotten. This elementary privilege is seldom trespassed upon, but here neither party had the opportunity of presenting its views before they found themselves bound by the court's edict. If and when the Appellate Division concludes substantial justice requires the invoking of the plain error rule and the issues have not been presented or argued, the litigants are entitled to notice of the

> points the court thinks constitute plain error and have a right to be heard before a final determination. The court should not deprive the parties of their day in court or their right to be heard on matters which may defeat their cause.

Although the Supreme Court invited supplemental briefs on "any theory of liability or defense previously pleaded" this hardly provided "notice of the points the court thinks constitute" error, especially in light of the construction of the court's ultimate decision from "inartful" language pleaded in the complaint.

Second, the Supreme Court's plurality opinion lacks evidence on which to rely in reaching its result. It relies in part on its observation that "[a]s trustee under the note issue (as well as in other capacities) Fidelity *presumably* received significant fees for its responsibilities . . . " 127 N.J. at 365, 605 A.2d 691 (emphasis added). The fourth vote essential to the majority twice presumed about Fidelity's fees, 127 N.J. at 375 and 376, 605 A.2d at 697.

Although the court describes itself as presuming, it is actually assuming. A presumption is an inference from *some* evidence.[14] Here, absent any evidence, the court assumed. A decision based on *no* evidence violates due process. *Thompson v. Louisville*, 362 U.S. 199 (1960).

In *Saunders v. Shaw*, 244 U.S. 317 (1917) this Court found that a decision of the Louisiana Supreme Court

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[14] New Jersey Evidence Rule 13, Definition of Presumption, says: "a presumption is a rebuttable assumption of fact resulting from a rule of law which requires such fact to be assumed from another fact or group of facts found or otherwise established in the action."

denied due process in similar circumstances. There the Louisiana Supreme Court, on rehearing for the first time, without evidence, held the plaintiff's land was low and marshy. It therefore concluded the land could not benefit from a levee, and was not subject to tax to pay for the bonds to build the levee. This Court noted (at 319-20):

> Probably the majority of the [state] supreme court thought that it was so plain on the uncontroverted facts that the case was within the principle of the Myles Salt Co. Case that to remand it would be an empty form, – a mere concession to technicality. It may turn out so, but we do not see in the record an absolute warrant for the assumption, and therefore cannot be sure that the defendant's rights are protected without giving him a chance to put his evidence in.
>
> The question remains whether the writ of error can be maintained. The record discloses the facts but does not disclose the claim of right under the 14th Amendment until the assignment of errors filed the day before the chief justice of the state granted this writ. Of course ordinarily that would not be enough. But when the act complained of is the act of the supreme court, done unexpectedly at the end of the proceeding, when the plaintiff in error no longer had any right to add to the record, it would leave a serious gap in the remedy for infraction of constitutional rights if the party aggrieved in such a way could not come here. The defendant was not bound to contemplate a decision of the case before his evidence was heard, and therefore was not bound to ask a ruling or to take other precautions in advance. The denial of rights given by the 14th Amendment need not be by

legislation. *Home Teleph. & Teleg. Co. v. Los Angeles*, 227 U.S. 278.

Here, this Court should remedy the denial of due process by the New Jersey Supreme Court as it has done in the prior cases.

CONCLUSION

For the foregoing reasons, we respectfully request that this Court grant a writ of certiorari and reverse the judgment of the New Jersey Supreme Court.

Respectfully submitted,

MICHAEL A. LAMPERT

July, 1992

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APPENDIX A

NEW JERSEY SUPREME COURT OPINION

127 N.J. 344, 605 A.2d 681

Supreme Court of New Jersey.

THEODORE RUDBART, NATALIE RUDBART, BEVERLY LITOFF AND BENJAMIN WELTMAN, PLAINTIFFS-RESPONDENTS, V. NORTH JERSEY DISTRICT WATER SUPPLY COMMISSION AND FIRST FIDELITY BANK, N.A., N.J., DEFENDANTS-APPELLANTS.

MADELINE OKIN, FOR HERSELF AND ON BEHALF OF ALL OTHER PERSONS SIMILARLY SITUATED, PLAINTIFF-RESPONDENT, V. NORTH JERSEY DISTRICT WATER SUPPLY COMMISSION AND FIRST FIDELITY BANK, N.A., N.J., DEFENDANTS-APPELLANTS.

Argued Jan. 3, 1991 – Decided April 27, 1992.

SYNOPSIS

Holders of new project notes issued by water supply commission brought action against commission and underwriter/indenture trustee, alleging that publication notice of early redemption of notes was inadequate. The Superior Court, Law Division, Passaic County, granted summary judgment for commission and underwriter/indenture trustee, and holders appealed. The Superior Court, Appellate Division, 238 N.J.Super. 41, 568 A.2d 1213, reversed and remanded. Underwriter/indenture trustee filed petition for certification, which was granted. The Supreme Court held that: (1) holders were bound by notes' provision for notice of redemption by publication,

even though notes fit within literal definition of "contracts of adhesion," and (2) constructive trust would be imposed on any profit obtained by underwriter/indenture trustee while in possession of monies of holders who had not redeemed by redemption date.

Appellate Division reversed and remanded.

Petrella, P.J.A.D., filed opinion concurring in part and dissenting in part.

Gaulkin, P.J.A.D., filed opinion concurring in part and dissenting in part in which Keefe and Clifford, JJ., joined.

Clifford, J., filed dissenting opinion.

*345 1. Securities Regulation

Doctrine of adhesion contracts should not be extended to regulated securities transactions.

2. Contracts

If agreement is characterized as "contract of adhesion," nonenforcement of its terms may be justified on other than such traditional grounds as fraud, duress, mistake, or illegality.

3. Contracts

Essential nature of "contract of adhesion" is that it is presented on take-it-or-leave-it basis, commonly in a standardized printed form, without opportunity for adhering party to negotiate except perhaps on a few particulars.

4. Contracts

Project notes issued by water supply commission fit within definition of "contract of adhesion," where notes were presented to public on standardized printed forms, on a take-it-or-leave-it basis without opportunity for purchasers to negotiate any of the terms.

5. Contracts

In determining whether to enforce terms of contract of adhesion, courts look not only to take-it-or-leave-it nature or standardized form of document, but also to subject matter of contract, parties' relative bargaining positions, degree of economic compulsion motivating the "adhering" party, and public interest affected by contract.

6. Waters and Water Courses

Purchasers of new project notes issued by water supply commission were bound by notes' provision for notice of redemption by publication, even though notes fit within literal definition of "contracts of adhesion," where notes were publicly-traded securities, and unique policy considerations attend such securities offerings.

*346 7. Appeal and Error

Supreme Court, upon disagreeing with Appellate Division's sole ruling that provision in project notes for notice of redemption by publication was unenforceable, would not remand matter to Appellate Division for consideration of whether note holders' complaint stated cause of action for relief on any of the other theories pleaded, where case was more than 5 years old, and thus it was best to resolve those claims on record before

Supreme Court. (Per Curiam opinion in which Chief Justice and two Justices joined and in which one Judge concurred in the result.)

8. Trusts

Constructive trust would be imposed upon any profits received by bank, which was underwriter and indenture trustee under new project notes issued by water supply commission, due to certain holders' failure to redeem notes by redemption date, where bank only notified its customers of redemption date while keeping other holders "in the dark," thus indicating a lack of fair dealing and possibly a lack of good faith; redemption date would be beginning point in calculating profit earned by bank on unclaimed funds, and bank would be allowed all of its reasonable expenses but for any possible benefits it had unjustly accrued. (Per Curiam opinion in which Chief Justice and two Justices joined and in which one Judge concurred in the result.)

H. Curtis Meanor, Newark, for defendant-appellant North Jersey Dist. Water Supply Comm'n (Podvey, Sachs, Meanor & Catenacci, attorneys; H. Curtis Meanor, H. Richard Chattman, and Steven Firkser, on the briefs).

Michael A. Lampert, Newark, for defendant-appellant First Fidelity Bank, N.A., N.J. (Kraft & McManimon, attorneys).

James J. DeLuca, Fort Lee, for plaintiffs-respondents (Okin, Cohen & Hollander, Fort Lee, and Gurtman, Shurkin & Brunt, Passaic, attorneys; James J. DeLuca, Fort Lee, and Thomas F. Brunt, Passaic, on the briefs).

*347 Joseph L. Yannotti, Deputy Atty. Gen., for amicus curiae State of New Jersey, (Robert J. Del Tufo, Atty. Gen. of New Jersey, attorney; Michael R. Clancy, Asst. Atty. Gen., of counsel; Sandra L.K. Manning, Deputy Atty. Gen., on the brief).

Peter N. Perretti, Jr., Morristown, submitted briefs on behalf of amici curiae New Jersey Bankers Ass'n and American Bankers Ass'n, (Riker, Danzig, Scherer, Hyland & Perretti, attorneys; Peter N. Perretti, Jr., Robert Fischer, III, John J. Farmer, Jr., and David P. Arciszewski, on the brief).

PER CURIAM.

We granted certification, 122 *N.J.* 137, 584 *A.*2d 210 (1990), primarily to consider the contention of First Fidelity Bank, N.A., New Jersey (Fidelity) that "in a published decision without precedent in the United States the Appellate Division had ruled that every investment security, whether a stock, bond, note or in some other form, is a contract of adhesion subjecting every term of the agreement to post hoc review for fairness." The Bank's petition for certification recited that "[n]ot only does this decision threaten to wreak havoc with the federally-regulated national securities market, but it would lead to the courts of this state being inundated with a group of law suits – securities litigation – that is among the most complex known to the bar."

[1] We granted leave to the Attorney General of New Jersey to appear as *amicus curiae* because of his contention that

> [t]his is the only decision extending the application of the doctrine of adhesion contracts to the

> sophisticated and highly-regulated world of securities transactions.
>
> The decision has the potential of opening to scrutiny by the courts the terms and conditions of notes and securities that have been sold to the public by governmental agencies throughout the State. The transfer of securities in the primary and secondary market hinges upon the certainty of the terms of such securities, and the assurance that those terms cannot be overridden by judicial *348 fiat. The broad implications of the decision by the Appellate Division could adversely affect on the sale of securities in this State.

The Attorney General suggested that the public debt financing to support the vast number of programs and projects necessary to the public health and welfare of the state would be endangered by the decision below. We agree that the doctrine of adhesion contracts should not be extended to regulated securities transactions. We now reverse the judgment of the Appellate Division, which was based on that court's holding that the subject securities constituted a contract of adhesion, but remand the matter to the Law Division for resolution of the remaining claims asserted by the plaintiffs.

I

These consolidated class actions were brought on behalf of holders of notes issued by defendant North Jersey District Water Supply Commission (Commission) to recover damages arising from an early redemption of the notes effected by newspaper notice. Plaintiffs' central

claim was that notice by publication, although specifically provided for in the notes, was inadequate and unconscionable.

A.

The Commission, a public corporation, operates and maintains a public water system serving northern New Jersey. *See N.J.S.A.* 58:5-1 to -58. By resolutions adopted April 25 and May 23, 1984, the Commission authorized the issuance of $75,000,000 in new project notes to provide interim financing for a portion of the cost of constructing a new water-supply facility and to pay certain outstanding obligations. *See N.J.S.A.* 58:5-44. The Commission and its underwriters, one of which was defendant Fidelity, negotiated the terms of the notes; Fidelity also was designated as the indenture trustee pursuant to *N.J.S.A.* 58:5-49 and as registrar/paying agent for the notes. The underwriters agreed to purchase the notes at the discounted *349 price of $73,800,000, intending to sell them on the secondary market at face value.

The project notes were issued on June 15, 1984. Issued in registered form, without coupons, in denominations of $5,000 or multiples thereof, the notes bore tax-free interest at the rate of 7 7/8 per annum payable on June 15th and December 15th. The notes fixed a June 15, 1987, maturity date, but, as set forth in both the Commission's authorizing resolutions and the Official Statement offering the issue to the public, were subject to earlier optional redemption:

The Notes are subject to redemption prior to maturity as a whole at the option of the Commission on 30 days published notice in a newspaper or newspapers of general circulation in the City of Newark, New Jersey and in the City of New York, New York on the dates and at the prices below:

Redemption Period (both dates inclusive)	Redemption Price (percent of par value)
June 15, 1986 to December 14, 1986	101 %
December 15, 1986 and thereafter	100 1/2%

If on the date fixed for redemption sufficient monies are available to the Trustee to pay the redemption price plus interest accrued to the date of redemption, the Notes shall cease to bear interest and shall not be deemed to be outstanding from such date.

The back of each of the issued notes bore similar language.

In the summer of 1985, the Commission decided to redeem the notes prior to maturity. In keeping with the procedures established in its 1984 resolutions, the Commission entered into an escrow deposit agreement with Fidelity, effective September 26, 1985, for the redemption of the notes on June 23, 1986. Among its other terms, the agreement provided for the Commission to deposit with Fidelity an escrow sum sufficient to pay the redemption price and interest until the redemption date, and for

Fidelity to publish a notice of redemption in accordance with the note terms.

*350 Although regular interest payments were mailed to registered noteholders on December 15, 1985, and June 15, 1986, neither those nor any other mailings informed the noteholders of the forthcoming early redemption. Fidelity did, however, provide the required notice by publication in *The Star Ledger*, *The New York Times*, and *The Wall Street Journal* on May 23 and again on June 9, 1986. The June 3, 1986, issue of *Moody's Municipal & Government Manual* also contained the call notice.

As of December 15, 1986, the holders of approximately $10,000,000 of the notes still had not redeemed. A number of note holders apparently made inquiries and complaints when they failed to receive their anticipated December 15, 1986, interest payments. Fidelity, at the Commission's request, mailed notice in early 1987 to those holders who had not yet redeemed, but declined the Commission's request to put the unredeemed funds in an interest-bearing account. The late-redeeming noteholders received the redemption price (101% of face value) and interest from June 15 to June 23, 1986, the date of redemption.

Plaintiffs filed separate actions in February and April 1987 on behalf of noteholders who allegedly had not learned of the redemption until after December 15, 1986. On various theories of negligence, conversion, breach of trust, constructive trust, and reformation, plaintiffs demanded that they be paid interest at the 7 7/8 % rate from June 23, 1986, until the dates that they submitted

their notes for redemption or other appropriate relief. The two actions were consolidated for trial.

At about the same time, a third plaintiff brought suit on behalf of late-redeeming noteholders in the United States District Court, *Ellovich v. First Fidelity Bank, N.A.*, No. 87-650 (D.N.J. Mar. 2, 1988). That case asserted federal securities-law claims as well as state-law causes of action. The district court dismissed the federal claims on a finding that the offering statement did not fail to disclose any material facts with respect to the nature and consequences of the early-redemption *351 notice by publication. The court then dismissed the state-law claims for lack of subject matter jurisdiction, stating that "[t]he state court is the proper forum for the litigation of these causes of action." The Third Circuit Court of Appeals affirmed. *Ellovich v. First Fidelity Bank, N.A.*, 862 F.2d 307 (1988).

The parties in the present actions then cross-moved for summary judgment on liability, based on a filed stipulation of facts. In a letter opinion, the Law Division held that "the notice provision clearly indicates that the newspaper publication method outlined would be the only type of notice given to the bond [sic] holders," and that "the failure to mail a notice to the plaintiffs when they could have, at the time they sent out interest checks," did not give rise to a cause of action. The Law Division granted summary judgment for defendants, finding that "the agreed upon notice by publication is binding on the plaintiffs and * * * such a method is not deficient as a matter of law." The court therefore entered judgment in favor of the Commission and Fidelity.

Before the Appellate Division, plaintiffs urged that the early-redemption notice by publication "was insufficient as a matter of law" and that the Commission and Fidelity had "converted [plaintiffs'] monies." They argued that the noteholders "had no power to negotiate with either the Commission or First Fidelity regarding the terms of the notes or the redemption provisions thereof," and that "[t]his is a classic example of a contract of adhesion." That was plaintiffs' first and entire reference to that theory of liability.

The Appellate Division adopted that theory. It reversed, holding that "a note or other security sold to the general investing public pursuant to standard form contractual provisions is a contract of adhesion"; that "[c]onsequently, if the security contains an unfair provision or the issuer fails to deal fairly with the investors, the issuer and its agents may be liable for any resulting damages"; and that "the failure * * * to give mail notice of the early redemption of the project notes was *352 unfair." *Rudbart v. North Jersey Dist. Water Supply Comm'n*, 238 *N.J.Super.* 41, 47, 568 *A.*2d 1213 (1990). The court reasoned that investment securities are generally "drafted by the issuer and presented to the purchaser on a take it or leave it basis," that the offering statements are "lengthy and difficult to understand," and that "members of the general investing public cannot reasonably be expected to understand the entire offering statement before deciding whether to purchase a particular security." *Id.* at 49, 568 *A.*2d 1213. Accordingly, courts should intervene "to afford protection to purchasers of securities from unconscionable contractual terms and other forms of overreaching by the issuers and their agents." *Ibid.* The

Appellate Division went on to hold that "the notice by publication provided by defendants did not constitute fair notice of the early redemption," *id.* at 51, 568 *A.*2d 1213, and that "defendants did not show any legitimate business reason for failing to give notice by mail." *Id.* at 56, 568 *A.*2d 1213. The court thus reversed and remanded for the determinations of damages and their allocation as between the Commission and Fidelity. *Id.* at 57, 568 *A.*2d 1213.

We granted certification and the Commission's motion to supplement the record. We also granted leave to the State of New Jersey, the New Jersey Bankers Association, and the American Bankers Association to join as *amici curiae.*

II

Plaintiffs do not contend that the project notes are ambiguous, nor do they claim that the Commission or Fidelity committed fraud or violated federal or state securities laws. Ordinarily, then, contract law would make the terms of the notes fully binding on plaintiffs. That law, based on principles of freedom of contract, was well stated in *Fivey v. Pennsylvania Railroad,* 67 *N.J.L.* 627, 52 *A.* 472 (E. & A. 1902), in which the court enforced a release incorporated in a standard-form contract:

> *353 A party who enters into a contract in writing, without any fraud or imposition being practiced upon him, is conclusively presumed to understand and assent to its terms and legal effect. [*Id.* at 632, 52 *A.* 472 (quoting *Rice v. Dwight Mfg. Co.,* 56 *Mass.* (2 Cush.) 80 (1848)).]

See also Henningsen v. Bloomfield Motors, Inc., 32 *N.J.* 358, 386, 161 *A.*2d 69 (1960) ("the basic tenet of freedom of competent parties to contract is a factor of importance"); Friedrich Kessler, *Contracts of Adhesion – Some Thoughts About Freedom of Contract*, 43 *Colum.L.Rev.* 629, 630 (1943) (hereinafter Kessler) (traditional contract principle is that "once the objective manifestations of assent are present, the author is bound").

[2,3] If an agreement is characterized as a "contract of adhesion" however, nonenforcement of its terms may be justified on other than such traditional grounds as fraud, duress, mistake, or illegality. *See* Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 *Harv.L.Rev.* 1174, 1190-92 (1983) (hereinafter Rakoff). Although the term "has acquired many significations," *id.* at 1176, the essential nature of a contract of adhesion is that it is presented on a take-it-or-leave-it basis, commonly in a standardized printed form, without opportunity for the "adhering" party to negotiate except perhaps on a few particulars. *Id.* at 1177; 3 *Corbin on Contracts* § 559C (Supp.1991); Kessler, *supra*, 43 *Colum.L.Rev.* at 632; Albert A. Ehrenzweig, *Adhesion Contracts in the Conflict of Laws*, 53 *Colum.L.Rev.* 1072, 1075 (1953); W. David Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 *Harv.L.Rev.* 529, 530 (1971) (hereinafter Slawson). We have previously defined "contract of adhesion" in just those terms: "[a] contract where one party * * * must accept or reject the contract * * * ." *Vasquez v. Glassboro Serv. Ass'n*, 83 *N.J.* 86, 104, 415 *A.*2d 1156 (1980). Such a contract "does not result from the consent of that party." *Ibid.*; *see also* Slawson, *supra*, 84 *Harv.L.Rev.* at 530 (standard form contracts "are

not, under any reasonable test, the agreement of the consumer or business recipient to whom they are delivered"). The distinct body of law surrounding contracts of adhesion represents the legal system's effort to determine *354 whether and to what extent such nonconsensual terms will be enforced. *Rakoff, supra,* 96 *Harv.L.Rev.* at 1230.

[4] The project notes involved here unquestionably fit our definition of contracts of adhesion. That is, they were presented to the public on standardized printed forms, on a take-it-or-leave-it basis without opportunity for purchasers to negotiate any of the terms.[1] But the observation that the notes fit the definition of contracts of adhesion is the beginning, not the end, of the inquiry: we must now determine as a matter of policy whether to enforce the unilaterally-fixed terms of the notes.

We have discussed those considerations in a number of earlier cases. The seminal case is *Henningsen, supra,* 32 *N.J.* 358, 161 *A.*2d 69, in which we invalidated an automobile manufacturer's standard-form disclaimer of its implied warranty of merchantability. In justifying that deviation from ordinary contract-law principles, we

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[1] The Commission and the underwriters negotiated the terms of the notes. However, although the underwriters presumably sought to enhance the attractiveness of the offer to prospective purchasers, the record does not indicate whether the negotiation addressed the interests of individual noteholders with respect to the form of early redemption notice or otherwise. *See* Lawrence E. Mitchell, *The Fairness Rights of Corporate Bondholders,* 65 *N.Y.U. L.Rev.* 1165, 1183 (1990). We thus reject defendants' suggestion that the noteholders had in fact negotiated the notice provision through the underwriters.

noted that a car is "a common and necessary adjunct of daily life," *id.* at 387, 161 *A.*2d 69, that the disclaimer form was used by the manufacturers of virtually all American passenger cars, *id.* at 390, 161 *A.*2d 69, that the "gross inequality of bargaining position * * * is thus apparent," *id.* at 391, 161 *A.*2d 69, and that the disclaimer represented "a studied effort to frustrate" the legislative grant of implied-warranty protection. *Id.* at 404, 161 *A.*2d 69.

In *Ellsworth Dobbs, Inc. v. Johnson,* 50 *N.J.* 528, 236 *A.*2d 843 (1967), we similarly invalidated a provision of a standardized real-estate-brokerage contract that obligated the seller to *355 pay a commission even if the buyer was financially unable or unwilling to complete the transaction. Relying on the "undue advantage" that arose from "monopolistic or practical control in the business transaction involved," *id.* at 553, 236 *A.*2d 843, we held that the offending contractual term would "thwart" the judicially-declared public policy of the State. *Id.* at 552, 555, 236 *A.*2d 843. Such a contractual provision accordingly is unenforceable "[w]henever there is substantial inequality of bargaining power, position or advantage between the broker and the other party involved." *Id.* at 555, 236 *A.*2d 843.

We applied similar principles in *Shell Oil Co. v. Marinello,* 63 *N.J.* 402, 307 *A.*2d 598 (1973), *cert. denied,* 415 *U.S.* 920, 94 *S.Ct.* 1421, 39 *L.Ed.*2d 475 (1974), to invalidate the termination provision of an oil company's lease and dealer agreement. We described the oil company as "the dominant party," and found that its relationship with its dealer "lacks equality in the respective bargaining positions"; moreover, a dealer who has operated the station for a period of years "cannot afford to risk confrontation

with the oil company." *Id.* 63 *N.J.* at 408, 307 *A.*2d 598. Because the parties' "grossly disproportionate bargaining power" had produced a "grossly unfair" term that contravened "the extant public policy of this State," we did not enforce that term. *Id.* at 408-09, 307 *A.*2d 598.

We again explored contracts of adhesion in *Vasquez, supra,* 83 *N.J.* 86, 415 *A.*2d 1156, in which we denied enforcement of a provision in a migrant worker's contract permitting eviction of a worker immediately on termination of his employment. We noted that contracts should be enforced where "the parties are in positions of relative equality and * * * their consent is freely given." *Id.* at 101, 415 *A.*2d 1156. However, we found that the migrant farmworker was in a position "analogous to that of a consumer who must accept a standardized form contract to purchase needed goods and services." *Id.* at 103, 415 *A.*2d 1156. We also found that the eviction terms of the standard-form contract conflicted with the demonstrated policy of the New Jersey courts and Legislature "in providing legal protection *356 for migrant farmworkers." *Id.* at 99, 415 *A.*2d 1156. Because the contract "[did] not result from the [worker's] consent," we invalidated its "unconscionable" eviction provision. *Id.* at 104, 415 *A.*2d 1156; see also *Kuzmiak v. Brookchester, Inc.,* 33 *N.J.Super.* 575, 111 *A.*2d 425 (App.Div.1955) (lease provision exculpating residential landlord from liability held contrary to public policy).

[5] Thus, in determining whether to enforce the terms of a contract of adhesion, courts have looked not only to the take-it-or-leave-it nature or the standardized form of the document but also to the subject matter of the contract, the parties' relative bargaining positions, the

degree of economic compulsion motivating the "adhering" party, and the public interests affected by the contract. Applying those criteria to the project notes, we find insufficient reason to invalidate the notice-by-publication term.

III

[6] The three considerations that lead us to that conclusion derive primarily from the fact that the project notes were publicly-traded securities. First, no investor was under any economic pressure to buy the notes. The notes were not consumer necessities. Prospective investors could choose from a vast selection of alternative equity and debt investments, including bonds and notes with various call and notice provisions. They were not driven to accept the Commission's notes because of a monopolistic market or any other economic constraint. Accordingly, the Commission did not enjoy a superior bargaining position permitting it to dictate its own terms. In short, the principal justifications for invalidating terms of a contract of adhesion are simply not present in a fully open and competitive securities market. Professor Slawson has cogently explained that reality:

> What economists call "perfectly competitive markets" (the markets for commodities or corporate securities, for example) automatically balance supply and *357 demand at a "market price," below which no buyer can hope to buy and above which no seller can hope to sell. A buyer for whom the products on such a market are essential buys them at prices and with other terms of sale that are adhesive, since he has no

> reasonable choice but to buy and, when he buys, no reasonable choice but to pay the prices and accept the other terms set by the market. Similarly, a seller for whom selling the product is essential sells at prices and other terms that are adhesive for him. But if the market is working free from improper influence, its lawmaking is legitimate. It is the mechanism through which society has implicitly chosen to enforce on buyers and sellers alike the prices and terms that meet the standards of supply and demand. Society has decided through its legitimate democratic processes that it wants those prices and terms imposed because theory teaches that they tend toward an optimum allocation of resources and are an incentive to efficiency. This decision serves as a standard of legitimacy, and since the contract is within this standard, it is legitimate and should be enforced. [Slawson, *supra*, 84 *Harv.L.Rev.* at 553-54.]

Cf. Madden v. Kaiser Found. Hosps., 17 *Cal.*3d 699, 131 *Cal.Rptr.* 882, 552 *P.*2d 1178 (1976) (where employee could select among several medical plans, some without arbitration provisions, arbitration provision of plan selected would be enforced against him).

Second, although securities are offered to the public on a take-it-or-leave-it basis, enforcement of their terms advances rather than contravenes well-established and important public policies. Securities are governed by Article 8 of the Uniform Commercial Code, *N.J.S.A.* 12A:8-101 to -408. *See N.J.S.A.* 12A:8-102; *N.J.S.A.* 12A:8-105(1). The Legislature has mandated that terms incorporated in such instruments shall be effective "[e]ven against a purchaser for value and without

notice." *N.J.S.A.* 12A:8-202(1). That provision, unique to investment securities and unlike the general Uniform Commercial Code principle that "[a] person 'knows' or has 'knowledge' of a fact when he has actual knowledge of it," *N.J.S.A.* 12A:1-201(25), is designed to provide certainty and stability in the marketing of securities. Its purpose is explained in the Official Comment:

> A purchaser must have some method of learning the terms of the security he is purchasing. The printing on the certificate or on the initial transaction statement ("ITS") is designed to notify the purchaser of those terms. If he purchases without examining the certificate or ITS, he does so at his peril, since *358 he is charged with notice of terms stated thereon. [*U.C.C.* § 8- 202 cmt. 1 (1977).]

We have recently observed that "the U.C.C. represents a comprehensive statutory scheme that satisfies the needs of the world of commerce, and courts should pause before extending judicial doctrines that might dislocate the legislative structure." *Spring Motors Distribs., Inc. v. Ford Motor Co.*, 98 *N.J.* 555, 577, 489 *A.*2d 660 (1985). The aim of Article 8 is to confer negotiability on securities; the statutory provisions should be implemented to ensure " 'the freedom of transferability which is essential to the negotiability of investment securities.' " 8 Anderson, *Uniform Commercial Code* § 8-105:3, :4 (3d ed. 1985) (quoting *E.H. Hinds, Inc. v. Coolidge Bank & Trust Co.*, 6 *Mass.App.* 5, 372 *N.E.*2d 259, 263 (Mass.App.Ct.1978)). Subjecting the terms of Article 8 securities to continual judicial

determinations of fairness would seriously impair the reliability and transferability of such instruments.[2]

Third, judicial review of the fairness of negotiable securities would be inconsistent with federal and state securities laws. Central to those statutes is the requirement of full disclosure of all material facts and the prohibition of fraudulent conduct in connection with the purchase or sale of securities. *See* 15 *U.S.C.A.* § 78j(b); *N.J.S.A.* 49:3-52(a)(b). Both Congress and our Legislature have chosen to protect investors by assuring that they be given all materials necessary to make an informed decision; accordingly, the federal and state legislative schemes do not provide for governmental review – judicial or otherwise – of the risk, fairness, good sense, or other substantive qualities of the offered security. Introducing a judicial-fairness review would effectively reject those legislative judgments in *359 favor of a view that full disclosure does not provide adequate protection to an investor.[3] Similarly inappropriate is the Appellate

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[2] Subjecting Commission notes to a judicial-fairness review could also undermine the statutory assurance that "[all] * * * provisions" of such obligations are "valid and legally binding contracts * * * enforceable by any * * * holder or holders." *N.J.S.A.* 58:5-48.

[3] The ability of the courts to conduct such evaluations of securities is, at the very least, questionable. Some state securities laws do provide for a fairness review, commonly performed by a specially-constituted executive commission prior to the issuance of a security. That procedure not only provides some degree of expertise and consistency but also assures that an investor can still rely on the express terms of the security once issued. *See* Louis Loss, *Fundamentals of Securities Regulation* 13 n. 21 (1988).

Division's suggestion that terms of securities should be subject to a judicial-fairness review because the documents "are lengthy and difficult to understand." 238 *N.J.Super.* at 49, 568 *A.*2d 1213. The forms of documents are dictated by, and their sufficiency is reviewable under, the securities laws.

We are satisfied that in light of the considerations we have stated, the asserted unfairness of the notice provision is not sufficient to justify judicial intrusion. Notice by publication does not contravene or frustrate any legislative policy. Moreover, although such notice may be constitutionally insufficient in certain settings, see, e.g., *Mullane v. Central Hanover Bank & Trust Co.*, 339 *U.S.* 306, 70 *S.Ct.* 652, 94 *L.Ed.* 865 (1950), plaintiffs have not demonstrated any established judicial policy against contractual provisions for notice by publication. We recognize that the Securities and Exchange Commission's recent guidelines for bond redemptions, SEC Exchange Act Release No. 23, 856 (Dec. 3, 1986), encourage notice by mail and that the Model Debenture Indenture Provisions of the American Bar Foundation, American Bar Foundation Corporate Debt Financing Project, *Model Debenture Provisions – All Registered Issues* § 1105 at 68 (1967), also suggest that notice of early redemption should be given to registered holders by mail. Moreover, we have no doubt that notice by mail here would have been preferable. But those considerations are not of sufficient weight to overcome the policy considerations that properly

restrain judicial oversight of the terms of publicly- *360 traded securities.[4]

We do not read *Van Gemert v. Boeing Co.*, 520 *F.*2d 1373 (2d Cir.), *cert. denied*, 423 *U.S.* 947, 96 *S.Ct.* 364, 46 *L.Ed.*2d 282 (1975), relied on by plaintiffs, as holding that a court may properly invalidate a notice-by-publication term of a security. In *Van Gemert*, holders of Boeing's convertible debentures challenged as unreasonable the published notice given by Boeing of redemption of the debentures. Although the plaintiffs argued that the indenture agreement was "in the nature of a contract of adhesion" and thus any "unconscionable features * * * are unenforceable as a matter of policy," *id.* at 1380, that court did not agree. Rather, it found that the newspaper notice was inadequate because the investors had not been adequately informed "by the prospectus or by the debentures" of the notice to be given. *Id.* at 1383. The court classified the limited scope of that holding in its later opinion after remand. *See* 553 *F.*2d 812 (1977). There the court stated that it had found "significant * * * the fact that the debentures did not explicitly set forth the type of notice [that the debenture holders] could expect" in the event of an early redemption, and accordingly had "held as a matter of law" what notice the debenture holders "were entitled to expect." *Id.* at 815. See also *Meckel v. Continental Resources Co.*, 758 *F.*2d 811 (2d Cir.1985), in

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[4] We also note that in the special circumstances of this case, invalidation of the "notice" provision might have a peculiarly unfortunate effect: the Commission, a public agency, and hence its ratepayers, might be required to pay interest on an escrow fund that was not under its control and that may have generated no income for the Commission.

which the same court described the *Van Gemert* holding as follows:

> Those debentures contained no indication as to the type of notice of redemption that was to be provided. It was the total lack of a notice provision in the debentures that we held necessary as a condition precedent to an imposition of a duty to provide "reasonable" notice. [*Id.* at 816.]

As we have already noted, plaintiffs here do not dispute that the notes and the Official Statement fully disclosed that notice *361 of redemption would be given by publication. If anything, *Van Gemert* suggests that such a fully disclosed term should be enforced.

We therefore conclude that although the project notes fit our literal definition of contracts of adhesion, plaintiffs are bound by the provision for notice by publication because of the unique policy considerations attendant on securities offerings.

IV

[7] Having disagreed, then, with the Appellate Division's sole basis for its decision, we would ordinarily remand the matter to the Appellate Division for consideration of whether plaintiffs' complaint stated a cause of action for relief on any of the other theories pleaded, *supra* at 351, 605 *A*.2d at 684, such as negligence, conversion, or constructive trust. Because the case is now more than five years old, we believe it best to resolve those claims on the record before us. After oral argument, we afforded the parties and the *amici* the opportunity to file

supplemental briefs on any theory of liability or defense previously pleaded.

[8] Although we disagree with our concurring member, Judge Petrella, on the issue of whether the notice provisions of these notes should be enforced, we agree with that part of his factual analysis that demonstrates the overwhelming inequity of allowing Fidelity to notify its customers of the redemption date while keeping the other investors in the dark and, as a result, perhaps benefiting from the use of the retained money. Because the trial court granted defendants' motion for summary judgment, we must grant to plaintiffs all the inferences that are favorable in the circumstances of this case.

Judge Petrella has already outlined that Fidelity wore many hats with respect to this transaction. As an underwriter, it earned income (although it undoubtedly incurred a risk) by subscribing to a percentage of the notes for resale to its customers or for its own account. In addition, it served as an *362 indenture trustee, which we take to mean that plaintiffs' money was to pass through Fidelity's hands as a stakeholder or escrow agent for the benefit of the noteholders. We believe that familiar principles of constructive trust apply to this latter function and entitle plaintiffs to at least a partial return of the interest earned on their money while it was retained by Fidelity.

Although plaintiffs' Appellate Division brief may inartfully describe their complaint as "establish[ing] a cause of action for conversion," the relief that they plainly sought under the first and third counts of the complaint established the theory of constructive trust as

an alternative basis for relief. In their supplemental memorandum, plaintiffs asked the Court as an alternative to the 7⅞ percent interest under the notes, that they be awarded the "interest on such [unredeemed] funds" by virtue of a general duty of a trustee to invest funds of a beneficiary. For while plaintiffs sought to "reform the terms of the notes issued to require notice by mail," they also sought to "impos[e] a constructive trust upon the unclaimed funds with all interest accrued thereon." With all of the favorable inferences that we must accord to plaintiffs' proofs, their complaint surely sets forth a claim to at least a partial return of any interest earned on these funds. Fidelity asserts that it deposited those funds in a non-interest-bearing account. There is no such thing as a non-interest-bearing account, for even those accounts that are denoted "non-interest-bearing" generate money for someone. For a bank, it might mean a change in margin requirements. The *amici*, American Bankers Association and New Jersey Bankers Association, make reference to the "float" on the unredeemed funds. Of such things we do not know but the clear implication is that interest was earned on those funds. We do know that in the companion litigation in the United States District Court, plaintiffs contended that the defendants' failure to state that the bank, not the investors, would earn interest on funds remaining unclaimed after any optional redemption constituted a material misrepresentation in violation of SEC *Rule* 10b-5.

*363 The district court concluded as a matter of law that *Rule* 10b-5 did not require the bank to disclose the fact that it would earn interest on the unclaimed deposits. That the bank was not required by federal law to disclose

that fact does not entitle it to retain all the interest earned on the funds.

The Law Division misperceived plaintiffs' claims to be limited to the demand that they be paid interest at the 7⅞ % interest rate from June 23, 1986, until they submitted their notes for redemption. As plaintiffs argued in their Appellate Division brief, all that need be established on those counts of the complaint asserting "conversion" of the funds was that "to allow either the Commission or Fidelity to *benefit* as a result of their failure to provide adequate notice of the redemption to the noteholders" would be unjust. (Emphasis added). Plaintiffs pointed out that Fidelity had held the escrow account "as a trust fund separate and apart from all other funds of the Commission or of the escrow account of First Fidelity for the sole benefit of the prior noteholders [holders of the 1984 project notes]."

As we have repeatedly emphasized, the concept of a constructive trust " 'is limited only by the inventiveness of men who find new ways to enrich themselves unjustly by grasping what should not belong to them.' " *Bron v. Weintraub*, 42 *N.J.* 87, 96, 199 *A.*2d 625 (1964) (quoting *Latham v. Father Divine*, 299 *N.Y.* 22, 85 *N.E.*2d 168, 170 (1949)). In the circumstances of this case, there can hardly be any doubt that this was a highly unusual situation in which one of the defendants was aware that it was holding other people's money as a result of selective unfairness. Deposition testimony of Alex Williams, Executive Vice-President of Fidelity, revealed that the bank's investment department gave written or oral notice to its customers prior to the June 23, 1986 call date that the notes had been called. This notice was given whether or not

those customers had safe-keeping accounts with the bank. Williams stated that Fidelity felt it would be "good business" to inform its customers. According to Williams, Fidelity took this action essentially *364 because the bank wanted to sell new bonds to its customers, to continue good customer relations, and to insure that its customers received notice. How far in advance of the June 23, 1986 call date Fidelity began notifying its customers is unclear. Williams also expressed the opinion, in response to the questions of the bank's attorney, that Fidelity maintained the list of purchasers of the project notes in connection with its underwriting activities for the issuance of the notes. When asked if he could have obtained that information from the trust department, he speculated that the trust department would have said "[i]t would have been a conflict of interest on their part. I don't know what they would have said because we didn't ask for it."[5] If as the *amici*, Bankers' Associations suggest, an agreement on the "float" may have been part of the transaction between Fidelity and the Commission, a further tension in Fidelity's duties would be created.

Charles Hoos, Senior Vice-President of Fidelity, testified that he was in charge of the corporate trust department and was aware that Fidelity had elected to give

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[5] Williams's statement is premised on principles of fiduciary law that Fidelity at other points disavows, despite its designation as "trustee," the fact that under the resolutions it was holding funds "in trust," and the heading "The Fiduciaries" in the Commission's resolution of April 25, 1984, which Fidelity apparently accepted. Moreover, the September 1, 1985, Escrow Deposit Agreement refers to the bank "in its capacity as trustee."

written notice of the redemption of the notes to customers of its investment department. Fidelity took the position before the Law Division, and in a September 9, 1988 letter brief following the oral argument there, that nothing in the record indicated that the personal notifications given by the investment department of the bank were in any way a result of the bank's position as trustee. It pointed to the deposition testimony of Fidelity's personnel that the investment department routinely telephones customers with respect to any major developments as to securities it sold. Fidelity took the position that the deposition testimony demonstrated that a "Chinese wall" existed between the trust department *365 and the investment department that was kept intact during this transaction.

As trustee under the note issue (as well as in the other capacities) Fidelity presumably received significant fees for its responsibilities, which in part included protecting the rights of noteholders. In that fiduciary capacity, for which it was paid, Fidelity now insists that it had no obligation to notify any noteholders in any fashion other than by the method of publication as set forth in the Commission's resolution. On the other hand, Fidelity admits that in its capacity as a bank, its investment department, which also receives fees for its services, including protection of customers, apparently undertook to give special notice to its own customers past and potential, with no obligation to do so. *See Rudbart, supra,* 238 *N.J.Super.* at 51 n. 4, 568 *A.*2d 1213. Thus, Fidelity argues that it can demand the benefits of both worlds, but without any additional obligations, particularly toward those who did not purchase the notes through it.

We need not debate whether an indenture trustee may be held to any fiduciary duty beyond that spelled out in the trust agreement. It is one thing not to surcharge a trustee for such an omission; it is quite another to let a trustee profit unfairly from a lack of fair dealing with the beneficiaries of its trust. The fact is that Fidelity decided to notify selectively its own customers. It acted in a manner that exhibited at least a lack of fair dealing and possibly a lack of good faith. This is a compelling case in which to apply the fairness doctrine because Fidelity was aware of the noteholders' lack of notice but acted for only its own customers. Although Fidelity acted in multiple capacities it should not be allowed to assume duties with one hand and to reject them with the other to its own unjust enrichment.

In unjust-enrichment cases courts may presume that the parties "intended to deal fairly with one another [and will] employ the doctrine of *quantum meruit* [ ] or equitable remedies *366 such as constructive or resulting trusts" in order to ensure that one party has not been unjustly enriched, and the other unjustly impoverished, on account of their dealings." *Carr v. Carr*, 120 *N.J.* 336, 352, 576 *A.*2d 872 (1990) (quoting *Kozlowski v. Kozlowski*, 80 *N.J.* 378, 390-91, 403 *A.*2d 902 (1979) (Pashman, J., concurring)). That principle of fair dealing pervades all of our contract law. *See Palisades Properties, Inc. v. Brunetti*, 44 *N.J.* 117, 207 *A.*2d 522 (1965). Although that principle will not alter the terms of a written agreement, *Marini v. Ireland*, 56 *N.J.* 130, 143, 265 *A.*2d 526 (1970), allowing plaintiffs some portion of the return on their withheld funds does not in any sense alter the written terms of the agreement between these parties. Here, the bank knew or

should have known that a large percentage of the noteholders would fail to receive notice of the early redemption, and knew exactly who they were. Nonetheless Fidelity did not take any steps to minimize the consequences of that failure, except to notify only its clients.

We can think of no fair reason, then, for holding that either defendant should be entitled to all of the income on plaintiffs' unredeemed funds. Surely, Fidelity recognized that it was a sound business practice and therefore fair dealing to assume that the customers to whom it sold a share of the notes should receive additional notice of the redemption. This multi-hatted trustee cannot simply pick and choose among those with whom it had contractual relationships without invoking the law's concern for "bringing about justice without reference to the intention of the parties." *St. Paul Fire & Marine Ins. Co. v. Indemnity Ins. Co. of N. Am., 32 N.J. 17, 22, 158 A.2d 825 (1960).* There might be a case in which administrative inconvenience in calculating interest to noteholders who straggle in might justify a denial of any interest. But this is not such a case. The sums involved here were, by the Commission's own account, described in depositions as "astronomical."

In short, this case was far from ripe for summary disposition. No affidavit before this Court has resolved the question of *367 whether a profit was made on the unclaimed funds (once as high as $25,000,000). Clearly, if the Commission shared any of the benefits with Fidelity it should be required to disgorge that amount. The pleadings and the depositions set forth an actionable claim for some equitable share of any income earned on plaintiffs'

funds. Because the liability we impose results from Fidelity's decision to prefer its customers over other noteholders so that its noteholders could redeem by June 23, 1986, that date should be the beginning point in calculating profit earned on the unclaimed funds. Plaintiffs suggest that the trial court should allow some reasonable time, after the June 23, 1986 redemption date, within which to expect that the funds would have been invested. Because we impose no duty on the fiduciary for failure to invest the funds, the use of the redemption date will simplify the remand. All that need be done is to determine what profit accrued to whom from the retention of plaintiffs' funds. Fidelity should be allowed all of its reasonable expenses but for any possible benefits it has unjustly accrued. Obviously, as the Commission points out, the funds had to be kept in liquid or very "short-term" investments or "overnights." We expect that the parties can readily develop the record necessary to conclude the matter with respect to this issue. We do not predicate our holding on 12 *C.F.R.* § 9.10 or *N.J.S.A.* 17:9A-35(D), although we note that both appear to assume that unclaimed fiduciary funds will not have been held uninvested, will reflect "short-term" market rates, and will allow for recognition of the fiduciary's cost or compensation for the services. Nor do we intend to create in this case, at this late date, a cause of action for breach of such directives. We intend only to remedy any unjust enrichment.

If the proofs disclose that the funds lay fallow and no benefit accrued to any of the defendants, then the court should dismiss the claims. We thus foresee no need for

the trial court to have to resolve any issues of indemnification. By definition, it would appear that Fidelity will have suffered no loss (and needs no indemnification) when it disgorges only profit unjustly earned *368 on plaintiffs' funds. In addition, the court may choose to fashion a class remedy without requiring any further administrative effort by defendants, and determine a reasonable allocation, even if by rough measure, among the plaintiffs' claims.

The judgment of the Appellate Division is reversed. The matter is remanded to the Law Division for further proceedings in accordance with this opinion.

The Chief Justice, Justices Handler and O'Hern, and Judges Gaulkin and Keefe join in Parts I, II, and III of the opinion. The Chief Justice, Justices Handler and O'Hern, and Judge Petrella join in Part IV.

Judge Petrella dissents from Parts I, II, and III of the opinion and files a separate opinion.

Judge Gaulkin files a separate opinion in which Justice Clifford and Judge Keefe join on the issue in Part IV of the opinion. They would enter judgment for the defendants.

Justice Clifford files a separate dissenting opinion and would enter judgment for the defendants for the reasons stated in his separate opinion.

PETRELLA, P.J.A.D. (temporarily assigned), concurring in part and dissenting in part.

Because I am unable to agree fully with the Court's conclusions, I concur in part IV of the opinion and vote for that result, but I dissent from parts I through III. In

my view, the "contract" under which the registered bearer notes were purchased by individuals or institutions is one of adhesion. That the notice provisions of the contract are not necessarily "unconscionable" does not resolve the issue of whether those provisions, if patently unfair to registered note holders under the circumstances, warrant judicial intervention.

In simplest terms a contract of adhesion, looked at from the dominant party's view, is merely one in which one party "adheres" to the terms which that party proposes, and does not *369 allow any realistic change or changes in the contract. See 3 *Corbin on Contracts* § 559A through I (Supp.1991); Rakoff, *Contracts of Adhesion: An Essay In Reconstruction*, 96 *Harv.L.Rev.* 1174 (1983). The non-dominant party is left with little, if any, choice and must, if desiring to contract, adhere to the contract terms with but minimal, if any, bargaining ability. *Black's Law Dictionary* (5th ed. 1979), defines the term "adhesion contract" as follows:

> Standardized contract form offered to consumers of goods and services on essentially 'take it or leave it' basis without affording consumer realistic opportunity to bargain and under such conditions that consumer cannot obtain desired product or services except by acquiescing in form contract. Distinctive feature of adhesion contract is that weaker party has no realistic choice as to its terms. * * * Not every such contract is unconscionable. [*Id.* at 38 (citations omitted).]

I disagree with the majority's notion that it is significant that investors were not under any economic pressure

to buy the project notes. Contrary to the majority opinion's view, the fact that consumer necessities are not involved should not be determinative of the issue. Contracts of adhesion are not limited to contracts for necessities or policies of insurance unless the Legislature, or perhaps a court, so declares based on stated policy reasons. In my view, there is neither viable reason nor necessity to exclude securities from contract scrutiny. Hence, applying definitional terms, investment securities of the type involved in this case are contracts of adhesion and should be treated as such unless specifically provided otherwise by statute.

Investment securities of a New Jersey issuer, including the type involved in this case, are subject to Article 8 of the New Jersey Uniform Commercial Code (UCC) as in effect at the pertinent times involved in this litigation. *N.J.S.A.* 12A:8-106[1] (as in effect prior to January 16, 1990), stated:

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[1] The note holders here are governed by the provisions of that section in effect prior to a 1990 amendment. That section was amended by L. 1989, c. 348, s 7, effective January 16, 1990, to read:

> The validity of a security and the rights and duties of the issuer with respect to registration of transfer are governed by the law (including the conflict of law rules) of the jurisdiction of organization of the issuer. The law (including the conflict of laws rules) of the jurisdiction of organization of the issuer governs the validity of a security, the effectiveness of registration by the issuer, and the rights and duties of the issuer with respect to:
>
> (a) Registration of transfer of a certificated security;

(Continued on following page)

*370 The validity of a security and the rights and duties of the issuer with respect to registration of transfer are governed by the law (including the conflict of law rules) of the jurisdiction of organization of the issuer.

The validity of the project notes issued on June 15, 1984, and the *rights of the issuer* regarding registration of transfer are not at issue here. The issue is the fairness or reasonableness of notice to a registered note holder solely by publication on May 23, 1986, and June 9, 1986, in two newspapers published in New York City, New York, and one newspaper published in Newark, New Jersey.[2] This fairness-of-notice concept is readily encompassed within the ambit of the "duties of the issuer with respect to registration of transfer," which are determined as to this issuer (the Commission) and these project notes by the laws of this jurisdiction.

It is unnecessary to conclude that the notice by publication provision, despite any inherent unfairness or unreasonableness, is unconscionable. The organic law of this State and its statutes and case law apply, including

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(b) Registration of transfer, pledge, or release of an uncertificated security; and

(c) Sending of statements of uncertificated securities.

This appeal does not involve the validity of the security. It involves the effectiveness of registration by the issuer as well as the rights and duties of the issuer with respect to transfer of a certificated security.

[2] The call notice was also published in *Moody's Municipal & Government Manual* on June 3, 1986.

the provisions of Article 1 of the UCC (generally applicable to all the UCC articles, except where stated to the contrary, see A. Abrams, *Introductory Commentary to N.J.S.A.* 12A:1-101 *et seq.*). See *N.J.S.A.* 12A:1-102.

N.J.S.A. 12A:8-202 does not limit inquiry into the issue of the fairness of notice provisions, particularly in light of the pertinent *371 language of *N.J.S.A.* 12A:8-106, which, as in effect at the pertinent times involved, applied New Jersey law to this issue of notes and the rights and duties of this issuer. *N.J.S.A.* 12A:8-202 makes various terms of the security applicable "[e]ven against a purchaser for value and without notice." The thrust of that section is to establish the right of an issuer to incorporate terms by reference to other documents or legal authorities. It does not affect challenges to the validity of the issue or security. *N.J.S.A.* 12A:8-202 recognizes the applicability of a state "constitution, statute, ordinance, rule, regulation, order or the like to the extent that the terms so referred to do not conflict with the stated terms."[3]

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[3] The legal opinion attached to the offering statement recites, among other things, that the "notes have been duly and validly authorized and issued in accordance with the Constitution, the Act and the applicable statutes of the State of New Jersey and in accordance with the Resolution; . . . " It goes on to state: "The enforceability of rights or remedies with respect to the Notes and with respect to the Contracts may be limited, however, by bankruptcy, insolvency, moratorium or other laws heretofore or hereby enacted affecting creditors' rights or remedies; . . . " That is an acknowledgement that the notes are subject to law, including case law.

Certainly, application of the law of fair notice does not conflict with the stated terms of these securities. Publication should not be construed as a stated term, nor as being to the exclusion of fair notice to registered note holders, nor as inconsistent with mailed notice. To expect that the absence of a reference to any of the cited authorities would mean other provisions of law have been ceded to the exclusive discretion of private law-making, *i.e.*, contract law, does not seem logical. Indeed, this section of the UCC has been interpreted as dealing with rights against the issuer, UCC § 8-202 (official comment). Because I would not construe Article 8 of New Jersey's UCC as limiting review of the fairness of the notice provisions for registered note holders whose names and addresses are readily ascertainable, I see no impediment to applying established principles of law to the notice.

*372 It needs to be emphasized that this appeal does not involve the financial provisions of the notes, the validity or genuineness of the notes, negotiability, or defenses of the issuer.

There is no basis in this record, based apparently on a "Stipulation of Facts,"[4] to conclude that the Appellate

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[4] The so-called stipulation submitted in plaintiffs' appendix bears no signatures and does not even contain a signature block for the Commission. Perhaps that was because the Commission did not participate in the proceedings before the trial court until a default was belatedly vacated before argument on the cross-motions for summary judgment. The Commission did not participate in the appeal before the Appellate Division. See 238 *N.J.Super.* at 47 n. 2, 568 *A.*2d 1213. The Commission's present attorneys were not involved in the earlier proceedings.

(Continued on following page)

Division's determination in this case of unfair notice to registered note holders would have any adverse effect on the issuance of municipal securities. Indeed, since the January 19, 1990, decision of the Appellate Division, nothing has been brought to the attention of this Court regarding any untoward consequence of that decision on the issuance of tax exempt securities in this state, other than some *ipse dixit* speculative arguments. It was essentially conceded at arguments before the Appellate Division and this Court that, as a practical matter, what happened in this case would not be repeated because written notice to all holders of registered securities is now the general rule, as well as the strong suggestion in "guidelines" (with virtually the force of regulations) of the Federal Securities and Exchange Commission. See 238 *N.J.Super.* at 52, 568 *A.*2d 1213. The record before the Appellate Division demonstrated a total lack of fair dealing with respect to the registered note holders as to the adequacy of the notice given. *Van Gemert v. Boeing Co.*, 520 *F.*2d 1373 (2d Cir.), *cert. denied*, 423 *U.S.* 947, 96 *S.Ct.* 364, 46 *L.Ed.*2d 282 (1975) (involving convertible debentures), and its progeny, on which the Appellate Division relied (see 238 *N.J.Super.* at 53-56, 568 *A.*2d 1213), present persuasive authority.

*373 The "Preliminary and Final Official Statement" dated May 16, 1984, on which defendants rely to support

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At this Court's request, the attorneys for First Fidelity submitted a copy of a stipulation bearing the signatures of only plaintiffs' attorneys. In any event, no party disputes the stipulation.

their claim that there was adequate notice and that plaintiffs individually, as well as all members of the class of registered note holders that they represent, should be bound by the contract, contains a provision somewhat inconsistent with defendants' argument. It provides that the "Official Statement is not to be construed as a contract or an agreement between the Commission and the purchaser or holder of any Notes. . . ."[5]

If the offering statement is not considered to be part of any contract, then all that the purchaser is left with is

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[5] This official statement contains, among other things, the following disclaimers:

> The information and the expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement, nor any sale made hereunder, shall under any circumstances create an implication that there has been no change in the affairs of the Commission, the Bank or the WSP Contracting Municipalities since the date hereof.
>
> * * *
>
> This Official Statement is not to be construed as a contract or an agreement between the Commission and the purchaser or holder of any Notes. Any statements made in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended merely as opinion and not as representations of fact. The information and the expressions of opinion herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Commission or the Bank since the date hereof.

the "fine print on the back of each note." 238 *N.J.Super.* at 44, 568 *A.*2d 1213. The record fails even to disclose whether plaintiffs received the offering statements before the purchase of the securities. *See Id.* at 49 n. 3, 568 *A.*2d 1213.

The Law Division judge appeared troubled at oral argument by the fact that First Fidelity Bank (First Fidelity) furnished its own customers with additional notice either by telephone or mail of the calling of the notes. The bank's attorney argued *374 then, and in a post-argument submission, that First Fidelity's trust department was separate and distinct from its investment department, was housed in a separate building, and was merely an "indenture trustee" and not a "common-law trustee." At that time, First Fidelity relied on a federal statute, presumably 15 *U.S.C.A.* § 77ooo(a)(1), and *Meckel v. Continental Resources Co.*, 758 *F.*2d 811, 816 (2d Cir.1985). Counsel also argued that the bank did not have fiduciary responsibilities.[6]

Deposition extracts submitted to the Law Division judge after oral argument (partially in response to deposition references in plaintiffs' brief) included portions of the testimony of Alex Williams, Executive Vice-president of First Fidelity, to the effect that at some point in 1986 the bank's investment department gave written or oral

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[6] This argument may have been raised because of the existence of 12 *C.F.R.* § 9.10 and *N.J.S.A.* 17:9A-35(D), which seem to require investment of unclaimed fiduciary funds. These authorities were not brought to the court's attention by any party, and might well impact on the bank's obligations and duties here.

notice of the call of the notes to its customers whether or not those customers had safe-keeping accounts with the bank, and that this was done prior to the June 23rd call date. He said that First Fidelity felt that it would be "good business" to inform its customers. The reasons given by Williams for First Fidelity's actions were essentially that the bank wanted to sell new bonds to its customers, to continue good customer relations, and its concern that its customers might not receive notice. It is unclear how far in advance First Fidelity commenced notifying its customers of the June 23, 1984, call date. Williams also expressed the opinion, in response to the questions of the bank's attorney, that First Fidelity maintained the list of purchasers of the project notes in connection with its underwriting activities for the issuance of the notes. When asked if he could have obtained that information from the trust department, he speculated that the trust department would have said "[i]t would *375 have been a conflict of interest on their part. I don't know what they would have said because we didn't ask for it."[7]

Charles Hoos, Senior Vice-president of First Fidelity, testified that he was in charge of the corporate trust department and was aware of the fact that First Fidelity

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[7] Williams' statement is premised on principles of fiduciary law that First Fidelity at other points disavows, despite its designation as "trustee," the fact that under the resolutions it was holding funds "in trust," and the heading "The Fiduciaries" in the Commission's resolution of April 25, 1984, which First Fidelity apparently accepted. Moreover, the September 1, 1985, Escrow Deposit Agreement refers to the bank "in its capacity as trustee."

elected to give written notice of the redemption of the notes to customers of its investment department.

The resolution adopted by the Commission on April 25, 1984, defined "fiduciary" as "the Trustee or Paying Agent." In section 504 of that resolution, as well as other sections, the trustee was charged with holding monies "in trust." Similar language appeared in Article VI of that resolution, entitled "The Fiduciaries," and also in a supplemental resolution dated May 23, 1984. Although the record does not contain the resolution appointing the bank as trustee or any document showing the trustee's actual acceptance of that appointment, it is undisputed that the bank acted not only as indenture trustee, and accepted responsibility under the resolutions, but also acted as a managing underwriter, Paying Agent, Registrar, and eventually Escrow Agent, and was presumably paid for each activity. A September 1, 1985, Escrow Deposit Agreement between the Commission and First Fidelity entered into in connection with First Fidelity being named "in its capacity as trustee" as "Escrow Agent" regarding the defeasance of the lien of the notes is attached as "Exhibit G" to the stipulation of facts.

First Fidelity took the position before the Law Division, and in a September 9, 1988, letter brief following the oral argument there, that nothing in the record indicated that the personal *376 notifications given by the investment department of the bank were in any way a result of the bank's position as trustee. It pointed to the deposition testimony of First Fidelity's personnel that the investment department routinely telephones customers with respect to any major developments as to securities it sold.

First Fidelity took the position that the deposition testimony demonstrated that a "Chinese wall" existed between the trust department and the investment department that was kept intact during this transaction. It also claimed a narrower scope of responsibility as an indenture trustee as referred to in *Meckel v. Continental Resources, supra,* 758 *F.*2d at 816 (duties limited to duties set forth in indenture).

However, it was not First Fidelity's trust department that was appointed as trustee, but rather the bank. Indeed, if, as suggested in *Meckel,* an indenture trustee does not have a trustee's duties of undivided loyalty and "is more like a stakeholder whose duties and obligations are exclusively defined by the terms of the indenture agent," *ibid.*, there is no need for the employment a trust department and no need to hide behind one side of a "Chinese wall." First Fidelity was not only one of the underwriters, but it was one of the managing underwriters of this issue. It was also the registrar/paying agent, escrow agent, and the indenture trustee for the project notes. *Rudbart, supra,* 238 *N.J.Super.* at 44, 568 *A.*2d 1213.

As trustee under the note issue (as well as in the other capacities) First Fidelity presumably received significant fees for its responsibilities, which in part included protecting the rights of note holders. In that capacity, for which it was paid, First Fidelity now says it had no obligation to notify any note holders in any fashion other than by the method of publication as set forth in the Commission's resolution. On the other hand, First Fidelity argues that in its capacity as a bank, its investment department, which also receives fees for its services, including protection of customers, apparently undertook

to give special notice to its own customers past and potential, with no obligation to do so. See *Rudbart, supra,* 238 *N.J.Super.* at 51 *377 n. 4, 568 *A.*2d 1213. Thus, First Fidelity argues that it can demand the benefits of both worlds, but without any additional obligations, particularly toward those who did not purchase the notes through it.

Although First Fidelity has a trust department, an investment department, and other departments or functions, it was First Fidelity that was appointed trustee, not one of its departments. It had fiduciary responsibilities under the terms of the resolutions, and those were not negated by federal law or a lesser standard of trusteeship.[8] The bank is charged, or should be charged here, with knowledge of all of the actions of all its departments and subdivisions, whether or not one department had actual contact with another. The fact is that First Fidelity elected to notify selectively its own customers. It acted in a manner that exhibited at best a lack of fair dealing and at worst, bad faith. It should not be allowed to assume duties with one hand and to reject them with the other. This case is a more compelling one to apply the fairness doctrine because First Fidelity knew about the situation with respect to note holders, but acted for only its own customers. It acted in multiple capacities and should not

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[8] This is aside from obligations imposed by law. 12 *C.F.R.* § 9.10 and *N.J.S.A.* 17:9A-35(D) appear to assume that unclaimed fiduciary funds are not to be held uninvested longer than reasonably necessary for proper account management. See *supra* at 374 n. 6, 605 *A.*2d at 696 n. 6.

be allowed to claim a judicially sanctioned split personality and hide behind an artificially created "Chinese wall" that it alternatively erects or dissolves based on whether it claims a trust duty, a stakeholder's duty, or some other function. It was First Fidelity, the entity, that assumed multiple positions and was appointed with the responsibility of indenture trustee, however defined. The existence of separate divisions for business purposes does not allow it to act in a disparate manner when it knows the names and addresses of registered note holders who are both customers and non-customers. *378 *See Buonviaggio v. Hillsborough Township Committee*, 122 *N.J.* 5, 15, 583 *A.*2d 739 (1991).

The majority opinion chooses to ignore the fact that in the related case of *Ellovich v. First Fidelity Bank, N.A.*, *N.J.*, No. 87-650 (D.N.J.1988), it was established that prior to issuance of the offering statement, First Fidelity's counsel suggested that notice of early redemption be given by mail rather than publication, based on his understanding that that was the usual form of notice to holders of registered securities. *Rudbart, supra*, 238 *N.J.Super.* at 53 n. 5, 568 *A.*2d 1213. Moreover, the "Stipulation of Facts" submitted in connection with the summary judgment motions stated: "Prior to the publication of the notices, Julie Saloveitch Miller, Administrator of the bond offering at First Fidelity, discussed the notice to be given with Gerald Volpe, Comptroller of the Commission." The Commission insisted on the publication notice. *Ibid.* Nonetheless, nothing requires that the published notice had to be the exclusive method of notice. There is also a reference in the argument before the Law Division

on September 2, 1988, and in submitted deposition testimony, to a discussion between the representatives of the Bank and the Commission about the type of notice to be given just before the time of notice by publication. To compound the problem, First Fidelity refused to deposit in an interest-bearing account the sums due the note holders who had not sought timely redemption even after the Commission had requested that action after the redemption date.[9] That a public entity may have participated in what resulted in unfair notice should not be a basis to excuse such action merely because rate payers may be affected. When dealing with the public, "government must 'turn square corners' rather than exploit litigational or bargaining advantages that might otherwise be available to private citizens." *W.V. Pangborne & Co.* *379 *v. New Jersey Dep't of Transp.*, 116 *N.J.* 543, 561, 562 *A.*2d 222 (1989). The government must act fairly and "with compunction and integrity." *Id.* at 562, 562 *A.*2d 222 (quoting *F.M.C. Stores Co. v. Borough of Morris Plains*, 100 *N.J.* 418, 427, 495 *A.*2d 1313 (1985)).

The Appellate Division decision is essentially limited to the notice provisions under the unique circumstances of this case. It does not affect the financial terms of the project notes in any way. Moreover, with that limitation highlighted, it is clear that the Appellate Division holding regarding the lack of fairness of limiting the notice provisions of the notes to publication in unspecified (in the

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[9] The bank apparently settled with some "good customers."

prospectus or note) newspapers circulating in New York City and Newark[10] and has nothing to do with:

(1) the financial terms of the notes;

(2) the sale and issuance of the notes;

(3) the risk of *investment* [That hardly includes the risk that the issuer would forget about the registered owner];

(4) the price or pricing of the security;

(5) the operation of the issuer or the underwriters; or

(6) damage or loss to the issuer or the bank [the cost of any written notice to individual registered bond holders would be *de minimis* and could even be deducted from interest after the redemption date].

In actuality there is no real burden placed on the securities industry by a requirement that fair notice be given to note holders in the issuance of registered securities. What occurred here was an atypical situation. The limited record before us indicates that with respect to all other issues, and particularly future tax exempt issues, individual notice to the registered security holders is the general practice, encouraged and in effect required by the SEC.

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[10] I doubt whether any court would have difficulty with the adequacy or fairness issue here if notice to registered note holders were to be solely in newspapers published and circulating, for instance, in Nome, Alaska and/or a designated city in any non-contiguous sister state of the United States.

Simply stated, fair dealing should be required. *Cf. New Brunswick Savings Bank v. Markouski*, 123 *N.J.* 402, 423-426, *380 587 *A.*2d 1265 (1991) (actual notice of an execution sale must be provided to judgment creditors whose names and addresses are reasonably ascertainable). *Ondërdonk v. Presbyterian Homes of N.J.*, 85 *N.J.* 171, 182, 425 *A.*2d 1057 (1981) (implied conditions include fairness and justice); *Bak-a-Lum Corporation of America v. Alcoa Building Products, Inc.*, 69 *N.J.* 123, 129-130, 351 *A.*2d 349 (1976) (implied covenant of good faith and fair dealing in every contract).

Although I differ with some of the reasoning in the Court's opinion, I concur in the result reached in Part IV. However, my preference would be to affirm substantially for the reasons expressed by the Appellate Division as reported at 238 *N.J.Super.* 41, 568 *A.*2d 1213 (App.Div.1990).

GAULKIN, P.J.A.D. (temporarily assigned), concurring in part and dissenting in part.

Part III of the *per curiam* opinion concludes that, although the project notes are contracts of adhesion, "plaintiffs are bound by the provision for notice by publication because of the unique policy considerations attendant on securities offerings." *Ante* at 361, 605 *A.*2d at 689. But Part IV then gives plaintiffs what the notice provision denies them: interest after the published redemption date. I join in Part III but dissent from the patently contradictory holding of Part IV.

The law and policy considerations recited in Part III persuasively support the conclusion that "the asserted unfairness of the notice provision is not sufficient to

justify judicial intrusion." *Ante* at 359, 605 *A*.2d at 688. However, in Part IV, the Court holds that such an intrusion is warranted because of the "overwhelming inequity" in Fidelity's "perhaps benefiting from the use of the retained money." *Ante* at 361, 605 *A*.2d at 690. That inconsistency is neither overcome nor explained away by the Court's application – without any invitation or argument of the parties – of labels of constructive trust and "fair dealing."

*381 The Court acknowledges that the "principle [of fair dealing] will not alter the terms of a written agreement." *Ante* at 366, 605 *A*.2d at 692. The same must be said of constructive trust principles: a party to a contract cannot be said to be unjustly enriched by a benefit granted by an otherwise enforceable term of the agreement. The Court says, however, that "allowing plaintiffs some portion of the return on their withheld funds does not in any sense alter the written terms of the agreement between these parties." *Ante* at 366, 605 *A*.2d at 692. Saying that does not make it so. The project notes provide that they "shall cease to bear interest" from the published redemption date, yet the Court awards plaintiffs an "equitable share of any income earned on [their] funds" after the redemption date. *Ante* at 366, 605 *A*.2d at 692. The Court has altered or negated the contractual term.

The Court implicitly recognizes that constructive trust or fair dealing principles could not overcome the contractual terms solely on a showing that the stakeholder, Fidelity, earned money on the unredeemed proceeds. Rather, the Court bases its finding of unjust enrichment on the fact that "Fidelity was aware of the noteholders' lack of notice but acted for only its own

customers." *Ante* at 366, 605 *A*.2d at 692. Why that should trigger the cause of action is unexplained. The Court does not suggest that Fidelity's investment department used inside information or otherwise acted improperly in notifying its customers of the redemption; nor does the Court hold that Fidelity's trust department had any fiduciary duties beyond those spelled out in the documents. *Ante* at 366, 605 *A*.2d at 692. If each department acted appropriately, how is it that their combined conduct was inequitable? Would the unfairness perceived by the Court evaporate if Fidelity had not informed even its own customers of the early redemption?

Simply stated, the Court's award of interest after the published redemption date cannot be squared with the purported enforcement of the contract. Melding the two holdings is not only logically unsustainable, it creates a new uncertainty about *382 the rights and liabilities of parties to securities transactions. Indeed, the Court's instructions for the remand proceedings, *ante* at 367-368, 605 *A*.2d at 692-693, indicate how unclear the obligations of Fidelity and the Commission remain even now. As Part III of the *per curiam* opinion convincingly demonstrates, avoidance of such uncertainty is one of the "unique policy considerations" justifying enforcement of the contract as written. Those policy considerations should at least restrain the Court from announcing rights and duties the litigants have never argued.

I would reverse the judgment entered in the Appellate Division and reinstate the Law Division judgment.

Judge KEEFE joins in this opinion.

CLIFFORD, J., dissenting.

On the only issue raised in the petition for certification and addressed at oral argument, the plurality opinion declares that the Appellate Division erred in "holding that the subject securities constitute a contract of adhesion." *Ante* at 348, 605 *A*.2d at 683. The opinion then muddies the waters by acknowledging, as surely it must, that "[t]he project notes involved here unquestionably fit our definition of contracts of adhesion," *ante* at 354, 605 *A*.2d at 686, a concession repeated *ante* at 360, 605 *A*.2d at 689. And so the plurality creates a little paradox, the jurisprudential equivalent of saying that even though something walks like a duck and quacks like a duck, it must be a donkey.

Aside from the distracting confusion generated by the plurality's foregoing flip-flop, I agree with so much of the opinion as holds that the notice provision is not unfair to the holders of the notes. Notice of redemption effected by publication was within the reasonable expectations of the noteholders, because the notice provision was legibly printed in the offering statement and investors are charged by *N.J.S.A.* 12A:8-202(1) with notice of terms set forth in the offering statement. The notice *383 provision was not unconscionable or against public policy or unduly oppressive.

Beyond all of that, I join in Judge Gaulkin's dissent from Part IV of the plurality opinion.

To recapitulate: I agree with Judge Petrella that the project notes are contracts of adhesion. I agree with the plurality that the notice provision is not unfair. And I agree with Judge Gaulkin's dissent from Part IV.

I would reverse the judgment of the Appellate Division and reinstate the Law Division's judgment in favor of defendants.

For reversal; remandment – Chief Justice WILINTZ, Justices HANDLER and O'HERN and Judge PETRELLA – 4.

For reversal; reinstatement – Justice CLIFFORD, and Judges GAULKIN and KEEFE – 3.

PETRELLA, Judge, concurring in remandment; dissenting in part – 1.

APPENDIX B

NEW JERSEY APPELLATE DIVISION OPINION

238 N.J.Super. 41, 568 A.2d 1213

*41 THEODORE RUDBART, NATALIE RUDBART, BEVERLY LITOFF AND BENJAMIN WELTMAN, PLAINTIFFS-APPELLANTS, V. NORTH JERSEY DISTRICT WATER SUPPLY COMMISSION AND FIRST FIDELITY BANK, N.A., DEFENDANTS-RESPONDENTS.

MADELINE OKIN, FOR HERSELF AND ON BEHALF OF ALL OTHER PERSONS SIMILARLY SITUATED, PLAINTIFFS-APPELLANTS, V. NORTH JERSEY DISTRICT WATER SUPPLY COMMISSION AND FIRST FIDELITY BANK, N.A., NEW JERSEY, DEFENDANTS-RESPONDENTS.

Superior Court of New Jersey

Appellate Division

Argued Sept. 18, 1989 - Decided Jan. 19, 1990.

SYNOPSIS

Holders of new project notes brought action against water supply commission and underwriter for new project notes alleging that notice of early redemption of notes was inadequate. The Superior Court, Law Division, Passaic County, directed that summary judgment be granted in favor of commission and underwriter. Holders appealed. The Superior Court, Appellate Division, Skillman, J.A.D., held that published newspaper notice of early redemption of project notes was not reasonably

calculated to provide actual notice of redemption to individual investors and was unfair and invalid.

Reversed and remanded.

1. CONTRACTS

A project note or other security sold to general investing public pursuant to standard form contractual provisions is a *42 contract of adhesion; consequently, if security contains unfair provision or issuer fails to deal fairly with investors, issuer and its agents may be liable for any resulting damage.

2. CONTRACTS

A contract where one party must accept or reject contract does not result from consent of that party; such a contract is a "contract of adhesion" whose legitimacy rests entirely on its compliance with standards in public interest.

3. CONTRACTS

Grossly unfair contractual obligations which result in assumption by the other contracting party of a burden which is at odds with common understanding of ordinary and untrained member of public, are considered unconscionable and therefore unenforceable.

4. CONTRACTS

Terms of project notes and other securities sold to general investing public and exercise by issuers and their agents of rights under those instruments are subject to judicial review on basis of alleged unconscionability or unfairness.

5. NOTICE

Where substantial property rights are involved, ordinarily within limits of practicality, notice of conduct affecting those rights must be such as is reasonably calculated to reach interested parties.

6. NOTICE

Notice by publication in newspaper is considered adequate under some circumstances, especially where it is supplemental to other action likely to come to attention of affected party or where it is not reasonably possible or practical to give more adequate notice; however, if substantial rights are involved, no other notice is likely to come to attention of affected party and it is feasible to provide more reliable notice, publication is not considered a fair form of notice.

*43 7. WATERS AND WATER COURSES

Published newspaper notice of early redemption of water supply commission new project notes was not reasonably calculated to provide actual notice of redemption to individual investors and, therefore, was unfair and invalid; commission never directly advised purchasers of notes that only notice they would receive of early redemption would be through published notice in newspaper, and offering statement and notes did not indicate any specific newspaper in which notice of early redemption would be published.

8. WATERS AND WATER COURSES

Underwriter for new project notes for water supply commission could not rely on statute for proposition that it could not be held liable to purchasers of notes for

interest on notes subsequent to redemption date where statute was not enacted until nearly six months after underwriter failed to give holders adequate notice of early redemption of their notes. *N.J.S.A.* 17:9A-35, subd. D.

Before Judges J.H. COLEMAN, MUIR and SKILLMAN.

James J. DeLuca argued the cause for appellants (Okin, Cohen and Hollander, attorneys for Madeline Okin, and Gurtman, Shurkin & Brunt, attorneys for Theodore Rudbart, et al.; Thomas F. Brunt and James J. DeLuca, on the brief).

Michael A. Lampert, Newark, for defendant-respondent, First Fidelity Bank, N.A. (St. John, Oberdorf, Williams, Edington & Curtin, attorneys; Robert J. Shaughnessy, Jr. and Michael A. Lampert, on the brief).

No appearance was made on behalf of respondent North Jersey Water Supply Commission.

The opinion of the court was delivered by

*44 SKILLMAN, J.A.D.

Defendant North Jersey District Water Supply Commission (the Commission) is a public body which operates and maintains a public water system that serves northern New Jersey. To provide interim financing for a portion of the cost of constructing a new water supply facility and to pay certain outstanding obligations, the Commission authorized the issuance of $75,000,000 in new project notes bearing interest at a rate of 7 7/8 % per

annum. Defendant First Fidelity Bank, N.A. (Fidelity)[1] was one of the Commission's underwriters as well as the indenture trustee and the registrar/paying agent for the notes. Plaintiffs were purchasers of the notes.

The Commission issued the project notes on or about June 15, 1984. Since the notes were in registered form, Fidelity had the address of each noteholder, to which it mailed interest payments semi-annually on June 15 and December 15. The notes had a stated term of three years but could be called for early redemption.

At some point each noteholder apparently received a copy of the Commission's offering statement, which set forth the terms of the notes. This document included a section which stated:

> The Notes are subject to redemption prior to maturity as a whole at the option of the Commission on 30 days published notice in a newspaper or newspapers of general circulation in the City of Newark, New Jersey and in the City of New York, New York on the dates and at the prices below:
>
> * * *
>
> If on the date fixed for redemption sufficient monies are available to the Trustee to pay the redemption price plus interest accrued to the date of redemption, the Notes shall cease to bear

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[1] Fidelity is the successor in interest of First National State Bank, which was identified in the Commission's supplemental resolution authorizing issuance of the project notes as an underwriter, the registrar/paying agent and the indenture trustee.

> interest and shall not be deemed to be outstanding from such date.

The fine print on the back of each note included similar language.

*45 In the summer of 1985 the Commission decided to exercise its option to redeem the notes prior to maturity. Consequently, it entered into an "escrow deposit agreement" with Fidelity, effective September 26, 1985, pursuant to which it fixed June 23, 1986 as the date of redemption.

Subsequent to the execution of this agreement, Fidelity sent two semi-annual interest payments by mail to the addresses previously designated by the noteholders. Neither mailing mentioned the scheduled early redemption of the notes. Moreover, neither Fidelity nor the Commission directly communicated in any other way with the plaintiffs regarding the redemption. Rather, the only notice of the early redemption given to the plaintiffs was by publication in several New York area newspapers and in Moody's Municipal and Government Manual.

As of December 15, 1986, nearly six months after the redemption date, the holders of approximately $10 million worth of the $75 million in project notes originally issued still had not redeemed their notes. After receiving telephone calls and written complaints from noteholders regarding their failure to receive interest payments on December 15, 1986, Fidelity, at the Commission's behest, provided mail notice in January of 1987 to the noteholders who had not yet redeemed. Most of these noteholders then redeemed their notes. However, they were only paid the redemption price (101% of the face value of

the notes) plus interest from June 15, 1986 to June 23, 1986. The Commission and Fidelity refused to pay any interest for the period subsequent to June 23, 1986.

Plaintiffs Theodore Rudbart, et al and Madeline Okin filed separate class actions in Passaic and Bergen counties against the Commission and Fidelity, alleging that the notice of the early redemption had been inadequate and seeking, among other things, interest from June 23, 1986 to the date of redemption. The trial court certified the Passaic County complaint as a class action and subsequently the complaints were consolidated in Passaic County.

*46 Plaintiffs and Fidelity filed cross-motions for summary judgment. Thereafter, these parties entered into a stipulation of facts on the liability aspects of the case, reserving the right to adduce additional evidence on the issue of damages should that become necessary. The trial court heard oral argument on September 2, 1988 and issued a written opinion on September 14, 1988 directing that summary judgment be granted in favor of the defendants. The trial court found that the offering statement and notes "clearly indicated" that "the only notice of redemption" the noteholders would receive would be by newspaper publication and concluded that this "agreed upon notice" was "binding on the plaintiffs and . . . not deficient as a matter of law."

While this matter was pending before the trial court, another noteholder who failed to see published notice of the redemption filed a class action in the United States District Court for New Jersey, *Ellovich v. First Fidelity Bank, N.A., New Jersey, et al.*, Docket No. 87-650. In a

written opinion filed March 2, 1988, the district court found that the plaintiff in that action had not presented any evidence that Fidelity failed to disclose a material fact in connection with the offering and consequently granted Fidelity's motion for summary judgment with respect to plaintiff's *Rule* 10b-5 claim, 17 *C.F.R.* § 240.10b-5 (1989). However, the federal court declined to exercise pendent jurisdiction with respect to state law claims. Consequently, the court expressly noted that "its ruling on plaintiff's federal claim provides no indication as to the viability of plaintiff's state law claims. The state court is the proper forum for the litigation of these causes of action." The Third Circuit Court of Appeals subsequently affirmed the dismissal of this federal complaint.

Plaintiffs appeal from the dismissal of their complaints, arguing, among other things, that the project notes are "a classic example of a contract of adhesion" and that "it would be unjust to allow either the Commission or First Fidelity to benefit as a result of their failure to provide adequate notice of the redemption *47 to the Note holders." Fidelity argues that the terms of an investment contract are not subject to invalidation on the grounds of unconscionability or unfairness.[2] In the alternative, Fidelity argues that published notice in the newspaper constituted adequate notice to plaintiffs of the early redemption of their notes.

[1] We conclude that a note or other security sold to the general investing public pursuant to standard form

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[2] Although plaintiffs seek reversal of the judgment entered below as against both Fidelity and the Commission, the Commission has not participated in this appeal.

contractual provisions is a contract of adhesion. Consequently, if the security contains an unfair provision or the issuer fails to deal fairly with the investors, the issuer and its agents may be liable for any resulting damages. We also conclude that the failure of the Commission and Fidelity to give mail notice of the early redemption of the project notes was unfair. Therefore, we reverse the judgment in favor of defendants and remand the matter for a determination of damages.

I

[2,3] Although it is "[a] basic tenet of the law of contracts . . . that courts should enforce contracts as made by the parties . . . , courts have become increasingly sensitive to overreaching in contracts where there is an inequality in the status of the parties." *Vasquez v. Glassboro Service Ass'n, Inc.*, 83 *N.J.* 86, 101, 415 *A.*2d 1156 (1980). Thus, the courts have recognized that "[a] contract where one party . . . must accept or reject the contract does not result from the consent of that party." *Id.* at 104, 415 *A.*2d 1156. Such a contract is "a contract of adhesion" whose "legitimacy rests entirely on its compliance with standards in the public interest." *Id.* at 104, 415 *A.*2d 1156, quoting Slawson, *Standard Form Contracts and Delegation of Lawmaking Power, 84 Harv.L.Rev.* 529, 566 (1971); *see also* Rakoff, *48 *Contracts of Adhesion: An Essay in Reconstruction*, 96 *Harv.L.Rev.* 1174 (1983). Consequently, "[g]rossly unfair contractual obligations . . . which result in an assumption by the other contracting party of a burden which is at odds with the common understanding of the ordinary and untrained member of the public, are considered unconscionable and therefore unenforceable."

Ellsworth Dobbs, Inc. v. Johnson, 50 *N.J.* 528, 554, 236 *A.*2d 843 (1967). "Moreover, in every contract there is an implied covenant of good faith and fair dealing." *Onderdonk v. Presbyterian Homes of N.J.*, *85 N.J.* 171, 182, 425 *A.*2d 1057 (1981).

Our courts have invalidated unconscionable or unfair contractual terms in a variety of contexts. *See, e.g., Henningsen v. Bloomfield Motors*, 32 *N.J.* 358, 385-404, 161 *A.*2d 69 (1960) (consumer contract for sale of automobile); *Ellsworth Dobbs, Inc. v. Johnson, supra*, 50 *N.J.* at 552-556, 236 *A.*2d 843 (listing agreement between real estate broker and seller of property); *Allen v. Metropolitan Ins. Co.*, 44 *N.J.* 294, 208 *A.*2d 638 (1965) (insurance policy); *Vasquez v. Glassboro Service Ass'n, supra*, 83 *N.J.* at 97-105, 415 *A.*2d 1156 (lease of living quarters by farmer to migrant farm worker); *Shell Oil Co. v. Marinello*, 63 *N.J.* 402, 307 *A.*2d 598 (1973) (franchise agreement); *see also Ingersoll Rand Co. v. Ciavatta*, 110 *N.J.* 609, 627, 542 *A.*2d 879 (1988) ("contractual provisions that require assignment of post-employment inventions . . . must be fair, reasonable, and just."); *Solari Industries, Inc. v. Malady*, 55 *N.J.* 571, 576, 264 *A.*2d 53 (1970) (covenant not to compete after termination of employment will be enforced only to the extent it "protects the legitimate interests of the employer, imposes no undue hardship on the employee, and is not injurious to the public."); *see generally Corbin on Contracts*, § 559A-§ 559I (Supp.1989).

[4] We are satisfied that the decisions dealing with contracts of adhesion in other contexts point to the conclusion that the terms of notes and other securities sold to the general investing public and the exercise by issuers

and their agents of *49 their rights under such instruments are subject to judicial review on the basis of alleged unconscionability or unfairness. Like consumer contracts, *Henningsen v. Bloomfield Motors, supra,* insurance policies, *Allen v. Metropolitan Ins. Co., supra,* residential leases, *Vasquez v. Glassboro Service Ass'n, supra,* and franchise agreements, *Shell Oil Co. v. Marinello, supra,* securities generally are contracts of adhesion, drafted by the issuer and presented to the purchaser on a take it or leave it basis. Moreover, offering statements, like other documents which the courts have viewed as contracts of adhesion, are lengthy and difficult to understand. For example, the Commission's offering statement for the project notes was 110 pages long, with 37 different sections and subsections and 5 appendices. Therefore, members of the general investing public cannot reasonably be expected to understand the entire offering statement before deciding whether to purchase a particular security.[3] Under these circumstances, as in connection with other contracts of adhesion, it is appropriate for the courts to afford protection to purchasers of securities from unconscionable contractual terms and other forms of overreaching by the issuers and their agents. *See* Note, "Convertible Securities: Holder Who Fails to Convert Before Expiration of the Conversion Period," 54 *Cornell L.Rev.* 271, 272 (1969).

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[3] Indeed, Fidelity acknowledged at oral argument that offering statements frequently are not even sent to the purchaser of a security until after the security has been bought. The record does not indicate whether plaintiffs received the offering statements before or after they purchased the securities.

II

[5-7] We consider next whether defendants' failure to give notice by mail to the noteholders of the early redemption was such unconscionable or unfair conduct. The leading cases dealing with the fairness of notice have involved the requirements of the Due Process Clause of the Fourteenth Amendment. In that context, the courts have recognized that the *50 fairness of a method of notice "depends on the particular circumstances." *Tulsa Professional Collection Services, Inc. v. Pope*, 485 *U.S.* 478, 108 *S.Ct.* 1340, 99 *L.Ed.*2d 565 (1988). Where substantial property rights are involved, ordinarily "within the limits of practicality notice must be such as is reasonably calculated to reach interested parties." *Mullane v. Central Hanover Bank & Trust Co.*, 339 *U.S.* 306, 318, 70 *S.Ct.* 652, 659, 94 *L.Ed.* 865 (1950). Notice by publication in the newspaper is considered adequate under some circumstances, especially where it is supplemental to other action likely to come to the attention of the affected party or where it is not reasonably possible or practical to give more adequate notice. *Id.*, 339 *U.S.* at 316-318, 70 *S.Ct.* at 658-659. However, if substantial rights are involved, no other notice is likely to come to the attention of the affected party and it is feasible to provide more reliable notice, publication is not considered a fair form of notice. *Id.*, 339 *U.S.* at 318-320, 70 *S.Ct.* at 659-660. The Court aptly observed in Mullane that:

> Chance alone brings to the attention of even a local resident an advertisement in small type inserted in the back pages of a newspaper, and if he makes his home outside the area of the newspaper's normal circulation the odds that the

> information will never reach him are large indeed.
>
> * * *
>
> Publication may theoretically be available for all the world to see, but it is too much in our day to suppose that each or any individual beneficiary does or could examine all that is published to see if something may be tucked away in it that affects his property interests. [*Id.*, 339 *U.S.* at 315, 320, 70 *S.Ct.* at 657, 660].

These observations regarding the fairness of notice by publication in the context of the due process requirements of the Fourteenth Amendment are equally applicable in the present context. The noteholders certainly have property rights in the notes and the continued payment of interest on the notes at least equal to the property rights of the trust beneficiaries involved in *Mullane*. Moreover, Fidelity has not suggested any reason why the test of the fairness of notice in the present context should be different from that in *Mullane* simply because *51 the redemption of plaintiffs' notes could be accomplished without resort to judicial proceedings.

Applying the principles expressed in *Mullane*, we conclude that the notice by publication provided by defendants did not constitute fair notice of the early redemption. Initially, we note that the Commission never directly advised the purchasers of the notes that the only notice they would receive of an early redemption would be through published notice in the newspaper. The offering statement indicates that early redemption would be "on 30 days published notice in a newspaper or newspapers of general circulation in the City of Newark, New

Jersey and the City of New York, New York." The back of the project notes contains similar language. However, neither document explicitly warned purchasers that newspaper notice would be the only notice they would receive. Consequently, we are unwilling to assume that an unsophisticated investor would have understood the language relied upon by defendants to mean that no other notice of redemption would be provided.

Furthermore, the offering statement and notes do not indicate any specific newspaper in which a notice of early redemption would be published. Therefore, even an investor who understood that only published notice of any early redemption would be given would have had to buy every newspaper of general circulation published in Newark or New York and read through the published notices every day while the notes were outstanding. We consider it unreasonable to expect an investor who has purchased a $5,000 project note, which may be only one of numerous securities he owns, to assume this burden.[4]

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[4] At oral argument, Fidelity urged that the brokers through whom the notes were purchased had a duty to give notice of the redemption to their customers and that defendants were entitled to rely upon that notice. However, defendants have not cited any statute, administrative regulation or judicial decision which imposes such a duty upon brokers. Nor has our independent research revealed any authority establishing such a duty. Consequently, we are unwilling to assume that brokers have such a legal duty or that they generally provide such notice to their customers as a matter of practice. In any event, even if some brokers give notice to their customers of redemptions which come to their attention, this would not absolve defendants of their responsibility to give notice reasonably calculated to reach noteholders.

*52 Our conclusion that the published notice of the early redemption was not reasonably calculated to reach all noteholders and hence was unfair is supported by the common understanding in the securities industry that notice of the redemption of registered securities will be given by mail. The Securities and Exchange Commission has issued guidelines for bond redemptions, entitled "Voluntary Minimum Standards for Processing Redemptions of Debt Securities," which recognize that only notice by mail is reasonably calculated to reach individual investors. Indeed, these guidelines suggest that notice of a redemption should be given by registered or certified mail or overnight delivery service:

> [T]he Commission . . . recognizes that many bondholders' certificates are not held by depositories, but are held individually or through other custodians. These bondholders, in the Commission's view, are often the least informed about the redemption process and bear significant financial loss due to missed redemptions and late redemption payments. The Commission, therefore, encourages voluntary efforts to improve the process by which these bondholders are informed of redemptions and are paid redemption proceeds. Issuers, their agents, and trustees should consider secured mailings [e.g., registered or certified mail or overnight delivery service] to all registered bondholders, follow-up notices to bondholders who have failed to deliver called bonds, mailed notices to holders of bearer bonds who provide their names and addresses for that purpose, and redemption notice publication in sources most likely to reach bondholders. [SEC Exchange Act Release No. 23,856 (December 3, 1986)].

The Model Debenture Indenture Provisions published by the American Bar Foundation also recognize that notice of any early redemption to holders of registered securities should be provided by mail:

> Notice of redemption shall be given by first-class mail, postage prepaid, mailed not less than 30 nor more than 60 days prior to the Redemption Date, to each Holder of Debentures to be redeemed, at his last address appearing in the Debenture Register. *American Bar Foundation Corporate Debt Financing Project, Model Debenture Provisions – All Registered Issues*, § 1105 at 68 (1967).

*53 Indeed, the senior vice president of Fidelity's own trust department testified in a deposition that the project notes issued by the Commission were the only registered public security of the more than 2,000 with which he was familiar which provided for notice of redemption solely by publication.[5]

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[5] Fidelity apparently suggested to the Commission that the noteholders be given notice by mail. The federal district court's opinion in Ellovich contains the following description of the circumstances under which notice of the redemption was given by newspaper publication rather than by mail:

> Prior to the issuance of the offering statement, the Bank's counsel suggested that notice of optional redemption be provided by mail rather than publication. Counsel's suggestion was based on his understanding that notice of redemption of registered notes was normally accomplished by mail and that mail was the most effective means of providing notice to bondholders. At the Commission's urging, however, the Bank kept the publication provision in the governing resolution and the offering statement.

Defendants have not even suggested that they had any reasonable basis for failing to give the holders of the project notes mail notice of the early redemption. Since the notes were registered, defendants had the addresses of all the noteholders. In fact, since Fidelity mailed two interest payments subsequent to the decision to redeem the notes, the last one on June 15, 1986 only eight days prior to the redemption date of June 23, 1986, notice of the early redemption could have been enclosed with these payments without defendants' incurring any significant cost. Therefore, the only plausible business reason for not giving the noteholders mail notice was to prevent a significant percentage of them from learning of the redemption, thus providing the defendants with the use of their capital for some period of time without the payment of interest. Because such an objective would be fundamentally unfair, we conclude that the published notice of redemption given by defendants was ineffective to suspend the running of interest on the unredeemed notes. *See Corbin, supra,* § 559E.

This conclusion is supported by the Second Circuit's decision in *Van Gemert v. Boeing Co.*, 520 F.2d 1373 (1975), *cert. den.* *54 423 *U.S.* 947, 96 *S.Ct.* 364, 46 *L.Ed.*2d 282 (1975). In that case, Boeing shareholders were given the right to purchase a convertible debenture which was subject to redemption on not less than 30 days notice. Although shareholders who purchased the debentures were given the option of registering them, in which event they would receive notice by mail of any redemption call, only 7% of the purchasers exercised this option. Purchasers who did not register their debentures were entitled only to published notice of any redemption. Boeing

exercised its right to redeem when the stock into which the debentures could be converted was worth more than triple their redemption value. A substantial number of unregistered debenture-holders failed to see the published notice and consequently failed to convert the debentures to common stock prior to the redemption date, at which time the conversion right expired.

A class action was brought by the debenture-holders who had failed to convert their debentures prior to the redemption date. One of the plaintiffs' contentions was that the indenture governing the debentures was a contract of adhesion between parties of disparate bargaining power, the unconscionable features of which were unenforceable as a matter of law. The court agreed with this contention and held that Boeing had an obligation to give "reasonably adequate notice of the redemption to the debenture holders." 520 *F.*2d at 1375. The court stated that "[t]he debenture holder's expectancy is that he will receive reasonable notice and it is his reliance on this expectancy that the courts will protect." 520 *F.*2d at 1385. The court concluded that Boeing had failed to adequately inform the purchasers of the debentures of the advantages of registration:

> Investors were not informed by the prospectus or by the debentures that they could receive mail notice by registering their debentures, and that otherwise they would have to rely primarily on finding one of the scheduled advertisements in the newspaper or on keeping a constant eye on the bond tables. [520 *F.*2d at 1383].

The court also concluded that the newspaper notice of the redemption given by Boeing was inadequate. Consequently, *55 Boeing was held liable for the damages suffered by the non-converting debenture-holders.

Fidelity argues that *Van Gemert* is distinguishable because the investors in that case were not told in the offering statement or the security itself how they would receive notice of any redemption. Fidelity relies upon the part of the Second Circuit's opinion following the remand in *Van Gemert*, reported at 553 F.2d 812 (2nd Cir.1977) (*Van Gemert II*), which states:

> We did find significant [in *Van Gemert I*] . . . the fact that the debentures did not explicitly set forth the type of notice which appellants could expect if Boeing decided to call the bonds. Without such a declaration, we held as a matter of law that appellants were entitled to expect that Boeing would employ a method of notification reasonably calculated to inform the debenture holders of the call. [*Id.* at 815].

However, the court did not state in either *Van Gemert* I or *Van Gemert II* that any form of notice, no matter how inadequate, would be sustained if it were set forth in the offering statement or the security. In fact, immediately following the passage from *Van Gemert II* relied upon by Fidelity, the court stated that

> [*Van Gemert I*] merely applied the settled principle, "that in every contract there is an implied covenant that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract. . . . " Simply stated, every contract contains the implied requirement of

> good faith and fair dealing. [*Ibid.*; citations omitted].

Fidelity also relies upon the statement in *Meckel v. Continental Resources Co.*, 758 F.2d 811, 816 (2nd Cir.1985) that in *Van Gemert I* "[i]t was the total lack of a notice provision in the debentures that we held necessary as a condition precedent to an imposition of a duty to provide 'reasonable' notice." However, the indenture involved in *Meckel* did provide for notice by mail of any redemption, and the court in that case specifically stated that "[i]n our view the provision in the debenture that notice would be given 'by mail' was not inherently unfair or unreasonable and it satisfied the debenture holders' reasonable expectations as to the notice they would receive." 758 F.2d at 816. Consequently, the court in *Meckel* had no occasion to *56 consider the fairness or enforceability of a provision for notice of the redemption of a registered security by publication only.

In any event, even if we read *Van Gemert and Meckel* as narrowly as Fidelity urges, we would conclude that New Jersey's approach to the enforcement of adhesive contractual terms, exemplified by *Henningsen, Allen, Ellsworth Dobbs, Marinello* and *Vasquez* (see *infra* at 47-49, 568 A.2d at 1216-1217), indicates that the published newspaper notice of the early redemption utilized by defendants was unfair and thus invalid, because it was not reasonably calculated to provide actual notice of the redemption to individual investors and defendants did not show any legitimate business reason for failing to give notice by mail.

III

Fidelity makes several other arguments which require brief comment. First, it argues that plaintiffs' claim is barred under principles of collateral estoppel by the federal district court's decision in *Ellovich*. More specifically, Fidelity argues that the district court found that the offering statement adequately disclosed to the plaintiff class that the sole notice of redemption would be by publication.

The short answer to this argument is that the district court's opinion contains no such finding. In fact, the district court expressly declined to consider the fairness of notice by publication, stating:

> Plaintiff contends that Rule 10b-5 required the Bank to disclose . . . that notice by publication was likely to be ineffective. Plaintiff presents evidence that the Bank knew that the notice by publication might be less effective than notice by mail, the usual method for providing notice of optional redemption of registered notes.
>
> Even assuming that the Bank was aware of the probable ineffectiveness of notice by publication, Rule 10b-5 does not require disclosure of such a fact. Such a requirement would be tantamount to compelling defendants to disclose (a) that their intention was to collect interest on unclaimed funds from investors who failed to receive actual notice of redemption, or (b) that such a plan was unlawful. As stated above, Rule 10b-5 does not require defendants "to confess a corporate wrongdoing or the invalid purpose of an act." [Citation omitted].

*57 Therefore, the district court in *Ellovich* rejected plaintiff's claim under Rule 10b-5 without making any finding as to the fairness of notice of the early redemption by publication only.

[8] Fidelity also relies upon *N.J.S.A.* 17:9A-35D for the proposition that it cannot be held liable to plaintiffs for interest on the notes subsequent to the redemption date. However, this subsection was not enacted until December 10, 1986, nearly six months after Fidelity failed to give plaintiffs adequate notice of the early redemption of their notes. Consequently, it has no applicability to this case. In any event, this subsection is not addressed to the liability of a bank which breaches its duties while acting as an agent for an issuer of securities.[6]

For the reasons previously stated, we reverse the judgment in favor of defendants and remand the matter for a determination of damages.

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[6] We have no occasion on this appeal to decide which defendant bears primary responsibility for the failure to give adequate notice of the early redemption. We also do not decide the scope of the class entitled to recover damages or the manner in which damages should be calculated. These issues should be addressed on remand.

APPENDIX C

NEW JERSEY SUPERIOR COURT, LAW DIVISION (TRIAL COURT) OPINION

SUPERIOR COURT OF NEW JERSEY

JOSEPH L. CONN
JUDGE

COURTHOUSE
PATERSON, NEW JERSEY 07505

September 14, 1988

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Re: Rudbart, et als and Okin v. North Jersey District Water Commission and First Fidelity Bank
Docket No. L-025715-87

Gentlemen:

The cross-motions for summary judgment here bring for disposition the claim by the class of bond holders herein for lost interest, conversion, unjust enrichment, etc. by reason of the failure of the defendants' issuer and

trustee - paying agent to notify the class of buyers by mail of the redemption of the bonds in question. The essential facts are not in issue and the exact dates of events need not be reiterated. It is enough to point out that no notice by mail was afforded the buyers. This, despite the fact that the bonds were registered and the names and addresses of the owners of the certificates were available to the defendant bank as shown by a mailing to them of an interest payment after the decision to redeem had been made. The parties agree that the issuance documents and the certificates themselves clearly indicated to the buyers of said bonds that the only notice of redemption would be by newspaper publication in Newark and New York City, which in fact was done through the *Star Ledger, New York Times* and the *Wall Street Journal.*

At some point after January 1987 (six months after the redemption date) the bank did mail a notice of said redemption to the remaining owners who had not submitted their bonds for payment. Another fact brought out in the pleadings was that the defendant bank's investment sales people did notify their own customers who were bond holders of the redemption. The proffer, however, indicates that these sales people utilized their own customer lists in order to notify those who were owners of this particular bond issue. Nothing submitted to the Court suggests or indicates any involvement in this by the bank's Trust Department.

The Court is satisfied that nothing in the bank's actions, including the failure to mail a notice to the plaintiffs when they could have, at the time they sent out interest checks, gives rise to a claim by said bond holders.

A reading of *Van Gemert v. Boeing*, 520 F. 2d 1373 (*2nd Cir.* 1975) or *Mullane v. Central Hanover Bank*, 339 *U.S.* 306 (1950) convinces the Court that the agreed upon notice by publication is binding on the plaintiffs and that such a method is not deficient as a matter of law.

Some added comment regarding *Van Gemert v. Boeing*, supra, is appropriate since it is the case law the plaintiffs primarily rely on and also because a cursory reading suggests that the actual holding of the Court is that in these types of redemption calls by an issuer, newspaper notice is insufficient as a matter of law. However, a closer analysis indicates that the Court was concerned about the failure to apprise holders that by registering their certificates they would receive notice by mail. In addition, the Court indicates that there was a failure to give adequate notice (information) on the certificate itself as to the type of notice that would be given. In other words, the defendants there, failed to adequately indicate how and what the notice would be. This is further confirmed by the Second Circuit itself when in the case of *Meckel v. Continental Resources*, 758 *Fed. 2d* 811 (*2nd Cir.* 1986) at page 816 in referring to *Van Gemert v. Boeing*, supra, it states:

> "It was the total lack of a notice provision in the debentures that we held necessary as a condition precedent to an imposition of duty to provide 'reasonable' notice."

Here the notice provision clearly indicates that the newspaper publication method outlined would be the only type of notice given to the bond holders.

Nor is the duty of the defendant First Fidelity owed to these plaintiffs any different by reason of the coincidental acts of the Investment Department people notifying their own customers among the plaintiffs' class of the redemption. It is not the type of action of the Trust Department that would require a conclusion that if it chooses a particular method for one class member, it must be utilized for all.

Likewise, the decision to send a mailing six months after the redemption date to those remaining owners who had not redeemed their bonds. That action by the bank was not selective - i.e. it was not sent to a few but rather to all members who had as yet not redeemed. It certainly was not an act amounting to an admission that the prior notice for publication breached any duty, etc.

A review of the supplemental memoranda submitted by both parties has simply confirmed all of which is stated above.

For all the reasons stated, therefore, the motions for summary judgment of the plaintiffs are denied and the motions for summary judgment by the defendants are granted.

Very truly yours,

/s/

Joseph L. Conn, J.S.C.

JLC:jf

APPENDIX D

CONSTITUTIONAL PROVISIONS SUPREMACY CLAUSE AND 14th AMENDMENT DUE PROCESS

UNITED STATES CONSTITUTION

ARTICLE VI

[2] This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

AMENDMENT XIV [1868]

Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

APPENDIX E

NATIONAL BANK ACT TRUST POWERS PROVISION 12 U.S.C. § 92a

(a) Authority of Comptroller of the Currency

The Comptroller of the Currency shall be authorized and empowered to grant by special permit to national banks applying therefor, when not in contravention of State of local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates, assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

* * *

(c) Segregation of fiduciary and general assets; separate books and records; access of State banking authorities to reports of examinations, books, records, and assets.

National banks exercising any or all of the powers enumerating [sic] in this section shall segregate all assets held in any fiduciary capacity from the general assets of the bank and shall keep a separate set of books and records showing in proper detail all transactions engaged in under authority of this section . . .

* * *

(d) Prohibited operations; separate investment account; collateral for certain funds used in conduct of business.

No national bank shall receive in its trust department deposits of current funds subject to check or the deposit of checks, drafts, bills of exchange, or other items for collection or exchange purposes. Funds deposited or held in trust by the bank awaiting investment shall be carried in a separate account and shall not be used by the bank in the conduct of its business unless it shall first set aside in the trust department United States bonds or other securities approved by the Comptroller of the Currency.

APPENDIX F

COMPTROLLER OF THE CURRENCY REGULATIONS EXCERPTS FROM 12 C.F.R. PART 9

12 C.F.R. § 9.7

Administration of Fiduciary Powers

(d) The trust department may utilize personnel and facilities of other departments of the bank, and other departments of the bank may utilize personnel and facilities of the trust department only to the extent not prohibited by law. Every national bank exercising fiduciary powers shall adopt written policies and procedures to ensure that the Federal securities laws are complied with in connection with any decision or recommendation to purchase or sell any security. Such policies and procedures, in particular, shall ensure the national bank trust departments shall not use material inside information in connection with any decision or recommendation to purchase or sell any security.

* * *

12 C.F.R § 9.8
Books and Accounts

(a) Every national bank exercising fiduciary powers shall keep its fiduciary records separate and distinct from other records of the bank. . . . .

(b) Every such national bank shall keep an adequate record of all pending litigation to which it is a party in connection with its exercise of fiduciary powers.

* * *

12 C.F.R. § 9.10

Funds Awaiting Investment or Distribution

(a) Funds held by a national bank in a fiduciary capacity which are awaiting investment or distribution shall not be held uninvested or undistributed any longer than is reasonable for the proper management of the account. Each national bank exercising fiduciary powers shall adopt and follow written policies and procedures intended to ensure that the maximum rate of return available for trust-quality, short-term investments is obtained upon funds so held, consistent with the requirements of the governing instrument and local law. Such policies and procedures shall take into consideration all relevant factors, including but not limited to the anticipated return that could be obtained while the cash remains uninvested or undistributed, the cost of investing such funds, and the anticipated need for the funds.

* * *

12 C.F.R § 9.13

Custody of Investments

(a) The investments of each account shall be kept separate from the assets of the bank, and shall be placed in the joint custody or control of not less than two of the officers or employees of the bank designated for that purpose by the board of directors of the bank or by one or more officers designated by the board of directors of the bank; and all such officers and employees shall be adequately bonded. To the extent permitted by law, a national bank may permit the investments of a fiduciary account to be deposited elsewhere.

(b) The investments of each account shall be either:

(1) Kept separate from those of all other accounts, except as provided in § 9.18, or

(2) Adequately identified as the property of the relevant account.

APPENDIX G

PRIOR FEDERAL COURT DECISION ABOUT THIS REDEMPTION

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

JOSEPH E. ELLOVICH, individually and as a class representative,	:	
Plaintiff,	:	Civil Action No. 87-650
v.		
FIRST FIDELITY BANK, N.A., NEW JERSEY, et al.,	:	OPINION
Defendants.	:	

SAROKIN, District Judge.

In this securities fraud case against a state commission which issued notes and a bank which underwrote them, defendant First Fidelity Bank moves for summary judgment.

BACKGROUND

For purposes of this motion, the court accepts the following facts contained in plaintiff's submissions as true.

In June 1984, Defendant North Jersey District Water Supply Commission (the Commission) issued $75 million

in 1984 Project Notes. Defendant First Fidelity Bank (the Bank), along with two other concerns, purchased the notes as managing underwriters and then resold them to the public. The Commission appointed the Bank as Trustee and Registrar/Paying Agent for the notes. The notes were issued in registered form, without coupons; the Bank was responsible for mailing biannual accrued interest checks to bondholders.

The notes were to mature on June 15, 1987, subject to a right of prior redemption. With respect to this "Optional Redemption," the Offering Statement stated:

> The Notes are subject to redemption prior to maturity as a whole at the option of the Commission on 30 days published notice in a newspaper or newspapers of general circulation in the City of Newark, New Jersey and in the City of New York, New York on the dates and at the prices below:
>
> * * *
>
> If on the date fixed for redemption sufficient monies are available to the Trustee to pay the redemption price plus interest accrued to the date of redemption, the Notes shall cease to bear interest and shall not be deemed to be outstanding from such date.

The back of each note contained similar language.

Prior to the issuance of the offering statement, the Bank's counsel suggested that notice of optional redemption be provided by mail rather than publication. Counsel's suggestion was based on his understanding that notice of redemption of registered notes was normally

accomplished by mail and that mail was the most effective means of providing notice to bondholders. At the Commission's urging, however, the Bank kept the publication provision in the governing resolution and the offering statement.

In June 1984, plaintiff Joseph Ellovich purchased Commission notes with a face value of $100,000.00.

In September 1985, the Commission elected to redeem the notes on June 23, 1986. Pursuant to the governing resolution creating the notes, notice of the redemption was published on May 23, 1986 and June 9, 1986. Plaintiff did not see the notice and was unaware of the redemption until December 31, 1986. On that date, plaintiff received a check in the amount of the redemption price plus interest accrued until June 23, 1986. The Bank refuses to pay interest accrued after June 23, the effective date of redemption.

Plaintiff's complaint alleges, in its first count, that both defendants violated federal securities laws by distributing an offering statement containing omissions of material fact. The remaining counts, all under state law, allege that both defendants committed fraud (second count), that the Bank violated its fiduciary duties to plaintiff (third count), and that the Bank was unjustly enriched (fourth count).

By order dated June 3, 1987, the court certified plaintiff as representative of the following class:

> All those persons who as Note holders did not present their Notes to the Bank for redemption and payment on June 23, 1986, the redemption

date set by the Commission, as averred in the Complaint.

The Bank now moves for summary judgment on plaintiff's complaint.

DISCUSSION

I. Plaintiff's federal claim (first count)

Plaintiff alleges that defendants omitted material facts in the offering statement used to market the notes and thereby caused the offering statement to be misleading, in contravention of § 10b of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5(b), 17 C.F.R. § 240.10b-5(b). More specifically, plaintiff contends that the offering statement omitted the following material facts:

1. The Bank, not the investors, would earn interest on funds remaining unclaimed after any optional redemption.

2. The Bank's benefit from investing unclaimed redemption funds created a conflict of interest with the investors.

3. Notice of redemption by publication would likely be ineffective.

Plaintiff's Brief in opposition at 17.[1] The Bank presents two reasons why their failure to divulge these matters does not expose them to Rule 10b-5 liability.

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[1] Paragraph 34 of plaintiff's complaint identifies six material facts. Plaintiff, in his brief, implicitly acknowledges that some of the allegations are duplicative.

First, the Bank contends that these matters are not "facts," but adverse characterizations that need not be disclosed under federal law. In reality, the Bank asserts, plaintiff seeks to impose federal liability for defendants, failure to disclose that their conduct violated state law. The federal courts have soundly rejected attempts at "bootstrapping" traditional state law claims into federal securities violations. *See, e.g., Santa Fe Indus. v. Green,* 430 U.S. 462, 477-80 (1977); *Biesenbach v. Guenther,* 588 F.2d 400, 402 (3d Cir. 1978); *Pullman-Peabody Co. v. Joy Mfg. Co.,* 662 F. Supp. 32, 33-34 (D.N.J. 1986).

Second, the Bank contends that the information withheld, even if considered to be "factual," is not "material" within the meaning of Rule 10b-5. The Supreme Court has defined materiality in the federal securities laws as

> a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

TSC Indus. v. Northway, Inc., 426 U.S. 438, 449 (1976) (interpreting Rule 14a-9 concerning proxy voting); *see Healey v. Catalyst Recovery of Pennsylvania, Inc.,* 616 F. 2d 641, 647 (3d Cir. 1980) (applying this definition under Rule 10b-5).

The court considers the Bank's arguments in connection with each of the omissions identified by plaintiffs.

1. The Bank, not the investors, would earn interest on funds remaining unclaimed after any optional redemption.

The offering statement informed investors that upon redemption "the Notes shall cease to bear interest and shall not be deemed to be outstanding from such date." Thus, investors were plainly informed that *they* would not earn interest on unclaimed funds after optional redemption.[2] Plaintiff contends that Rule 10b-5 required defendants to disclose as well that *the Bank* would earn the interest.

The Bank characterizes plaintiff's contention as an attempt to "federalize" its claims (contained in the third and fourth counts) that the Bank's conduct violated state law. Plaintiff responds that the mere *fact* that the Bank would receive the interest would have been material to investors, regardless of whether the Bank's conduct was proper under state law.

The court concludes, as a matter of law, that Rule 10b-5 did not require the Bank to disclose this fact. To an

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[2] Plaintiff, though not alleging any affirmative misrepresentation in his complaint, suggests that the offering statement "implied" that investors would be entitled to interest on unclaimed funds after redemption. Plaintiff's Brief in Opposition at 20-21. Plaintiff argues that the reference in the offering statement to the Bank as "Trustee" would lead a reasonable investor to conclude that interest generated from unclaimed money in the Bank's hands would accrue to the investors as "beneficiaries." The court rejects this position in light of the express statement that "the Notes shall cease to bear interest" upon redemption.

investor who understood that he or she would not receive interest on unclaimed funds, information as to who would receive this interest, in the abstract, would not be material. Plaintiff stresses, though, that *the Bank* was to receive the interest. Again, however, the significant fact for an investor was that interest would not accrue on the Note after the date of redemption; that the Bank would receive the interest would not affect the quality, of the investment. In fact, an investor who read and understood the disclosed facts could easily conclude that interest on unclaimed funds would accrue to the Bank. Perhaps disclosure that the Bank would receive the interest would have alerted an inattentive investor to the fact that he or she would not receive the interest on unclaimed funds. The Bank, however, having disclosed this latter fact, was under no obligation to emphasize it.

2. The Bank's benefit from investing unclaimed redemption funds created a conflict of interest with the investors.

The court has ruled above that Rule 10b-5 imposed no obligation on the Bank to disclose the fact that it would receive interest on unclaimed funds after redemption. Given this ruling, Rule 10b-5 cannot require the Bank to disclose that this arrangement created a conflict of interest between it and the investors.

Independently, the Bank, even if required to disclose the its receipt of the interest, would not be liable under Rule 10b-5 for failure to disclose this alleged conflict of interest. As stated above, Rule 10b-5 does not require

defendants to disclose such negative characterizations of their conduct. *See, e.g., Biesenbach v. Guenther*, 588 F. 2d 400, 402 (3d Cir.1978).

3. Notice of redemption by publication would likely be ineffective.

The offering statement explains that notice of optional redemption will be accomplished through publication in Newark and New York newspapers. Plaintiff contends that Rule 10b-5 required the Bank to disclose additionally that notice by publication was likely to be ineffective. Plaintiff presents evidence that the Bank knew that notice by publication might be less effective than notice by mail, the usual method for providing notice of optional redemption of registered notes.

Even assuming that the Bank was aware of the probable ineffectiveness of notice by publication, Rule 10b-5 does not require disclosure of such a fact. Such a requirement would be tantamount to compelling defendants to disclose (a) that their intention was to collect interest on unclaimed funds from investors who failed to receive actual notice of redemption, or (b) that such a plan was unlawful. As stated above, Rule 10b-5 does not require defendants "to confess a corporate wrongdoing or the invalid purpose of an act." *See, e.g., Pullman-Peabody Co. v. Joy Mfg. Co.*, 662 F. Supp. 32, 34 (D.N.J. 1986). The Bank discharged its federal disclosure obligations by revealing the method of publication; Rule 10b-5 did not require the Bank to evaluate the efficacy of that method.

* * *

The court concludes that plaintiff have not presented evidence that the Bank failed to disclose a material fact in connection with its offering of the notes. Therefore, the Bank is entitled to judgment as a matter of law on plaintiff's Rule 10b-5 claim. The court grants the Bank's motion for summary judgment as to the first count of plaintiffs' complaint.

II. Plaintiff's state law claims

Given the court's grant of summary judgment to defendants on plaintiff's sole federal claim, the court, in the absence of extraordinary circumstances, should refrain from exercising pendent jurisdiction over plaintiff's remaining state claims. *See, e.g., Cooley v. Pennsylvania Housing Finance Agy.*, 830 F. 2d 469, 475 (3d Cir. 1987); *Tully v. Mott Supermarkets, Inc.*, 540 F. 2d 187, 196 (3d Cir. 1976). Because plaintiff has failed to indicate any such circumstances, the court dismisses plaintiffs, state law claims for lack of subject matter jurisdiction.

The court notes that its ruling on plaintiff's federal claim provides no indication as to the viability of plaintiff's state law claims. The state court is the proper forum for the litigation of these causes of action.

CONCLUSION

The court grants the Bank's motion for summary judgment as to the first count of plaintiff's complaint. The

court dismisses the remaining counts of plaintiff's complaint against the Bank for lack of subject matter jurisdiction.

/s/

H. LEE SAROKIN, U.S.D.J.

Date: March 2, 1988

Original to Clerk, U.S. District Court

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APPENDIX H

FEDERAL QUESTION EXCERPT FROM BANK'S BRIEF IN SUPPORT OF CROSS-MOTION FOR SUMMARY JUDGMENT IN STATE TRIAL COURT

* * *

ARGUMENT

I.

The Prior Adjudication in Federal Court and the Stipulated Facts Show the Notice Given Was Not Unreasonable and Require Dismissal of This Action.

A. No Case Justifies Invalidating the Notice.

The Stipulated Facts in this case contain, as Exhibit A, a copy of Judge Sarokin's decision granting First Fidelity summary judgment in *Ellovich v. North Jersey District Water Supply Commission and First Fidelity Bank, N.A., New Jersey*, Civ. Action No. 87-650 (HLS) (hereinafter "Ellovich Op."). That action was brought on behalf of the same class of plaintiffs as in the case at bar, albeit they were there represented by a different named plaintiff. Each case was duly certified as a class action by the respective Court. Compare Ellovich Op. at 3 with Stipulated Facts at 2. The two defendants in the two actions are identical.

In these circumstances it is well established that facts determined in the Ellovich action cannot be relitigated under the doctrine of collateral estoppel and claims are barred from relitigation by *res judicata*. *Supreme Tribe of Ben Hur v. Cauble*, 255 U.S. 356, 65 L. Ed. 673 (1921).

These principles have been followed by the courts of New Jersey in similar circumstances. In *Gregory Marketing v. Wakefern Food Corp.*, 207 N.J. Super. 607 (Law Div. 1985) plaintiffs had sued in federal court under the federal and state antitrust laws. The federal court dismissed the federal claims with prejudice, and the state claims without prejudice. 207 N.J. Super. at 613. Plaintiffs then brought a two count complaint in state court, asserting the claims that had been dismissed without prejudice.

In a thoughtful opinion the Law Division granted summary judgment dismissing the first count of the complaint. The court held that both the doctrines of *res judicata*, 207 N.J. Super. at 618-620, and collateral estoppel, 207 N.J. Super. at 620-624, barred the first count. Neither the pendency of an appeal, 207 N.J. Super. at 621, 624, nor the dismissal of the state claims "without prejudice", 207 N.J. Super. at 613, was a bar to the Law Division holding that the federal claims adjudicated had preclusive effect on parallel state claims.

The Law Division cited with approval (at 620):

> *Salveson v. Western States Bankcard Association*, 731 F.2d 1423, 1433 (9th Cir. 1984), in which summary judgment on plaintiff's federal antitrust claim in federal court was held to bar a subsequent claim under the state antitrust act. While recognizing that state antitrust laws "are not preempted by the federal antitrust laws," 731 F.2d at 1432, the Court of Appeals held:
>
> > (In Moitie), having elected to 'pitch' their pleadings under the federal statute, and having suffered summary judgment . . . appellants' antitrust claims became subject

> to a bar by judgment which was extensive as those claims could be deemed to be well pleaded. . . . Analytically, therefore, the judgment bar extended to the issues framed, not to the statutory labels invoked.
>
> * * *
>
> The federal judgment has extinguished the substance of appellants' antitrust claims, finally and conclusively. [Id. at 1433; emphasis added).

See also *Woods Exploration & Producing Co. v. Aluminum Company of America*, 438 F.2d 1286, 1312-23, 1315 (5th Cir. 1971) (*res judicata* precludes litigation of state antitrust claim in state court based on judgment rendered in federal court on federal antitrust claim if state and federal claims involve "substantially the same wrongs measured by similar standards of liability").

Plaintiffs' first argument in their brief in this Court (at 5) is that notice by publication, "was not reasonably calculated to give notice of the redemption to the Noteholders and thus, was insufficient as a matter of law."

The gravamen of this claim is substantially similar to the third claim confronting the federal court in Ellovich. (Ellovich Op. at 6-7). There the class claimed notice of redemption by publication would likely be ineffective and the Bank had not adequately disclosed this. The court ruled otherwise, and the similarity between that attack on notice by publication and this one requires this court to rule likewise.

APPENDIX I

EXCERPT FROM REPLY LETTER BRIEF IN STATE TRIAL COURT

2. The Mullane claim is barred by res judicata.

As we explained in our brief in opposition to plaintiffs' motion for summary judgment and in support of our Cross-Motion for summary judgment (at 9) there was a prior litigation in federal court involving identical parties arising from the same redemption. This prior litigation bars the *Mullane* claim.

There is indisputably jurisdiction in federal court over constitutional claims. See 28 U.S.C. § 1331 ("The district courts shall have original jurisdiction of all civil actions arising under the Constitution . . . of the United States"; *Bivens v. Six Unknown Named Agents*, 403 U.S. 388 (1971). Thus, the *Mullane* claim might have been asserted in federal court.

Claims that might have been asserted in a prior case are barred by *res judicata*. In *Newark v. North Jersey Dist. Water Sup. Comm.*, 106 N.J. Super. 88, 99 (Ch. Div. 1968) the court held:

> It also follows that since the facts herein alleged in support of Newark's complaint to rescind the two water supply contracts could have been asserted to defeat the Commission's claim in the prior suit in which it sought an adjudication respecting the binding effect of the two contracts, the first suit is *res judicata* of the issues raised here. The judgment of a court of competent jurisdiction on a question of law or fact or on a mixed question of law or fact, once litigated and determined, is, so long as it stands

unreversed, conclusive upon the parties and their privies. *Reeves v. Jersey City*, 30 N.J. Super. 392 (App. Div. 1954), *affirmed* 16 N.J. 529 (1954); *Hudson Transit Corp. v. Antonucci*, 137 N.J.L. 704 (E. & A. 1948); *Bango v. Ward*, 12 N.J. 415 (1953). The court in *Reeves, supra*, also stated:

> " * * * where such prior judgment is founded on the claim or demand sued upon in the later suit, it is conclusive not only as to all matters which were actually litigated and decided, *but also as to all matters which might have been properly raised in said prior suit.*" at p. 400 (Emphasis supplied)

To the same effect see *Public Service Electric & Gas Co. v. Waldroup*, 38 N.J. Super. 419 (App. Div. 1955); *Middlesex Concrete, etc., Corp. v. Borough of Carteret*, 35 N.J. Super. 226 (App. Div. 1955); *Ferger v. Local 483*, 94 N.J. Super. 554, 564 (Ch. Div. 1967), *affirmed* 97 N.J. Super. 505 (App. Div. 1967).

Indeed the case at bar is the mirror image of *Atkinson v. Pittsgrove Tp.*, 193 N.J. Super. 23 (Ch. Div. 1983), where the court noted approvingly that a federal court had dismissed a prior suit brought by Atkinson in federal court on the ground that even earlier Atkinson had brought a suit in state court (at 193 N.J. Super. 28):

> [The district court] concluded that the pending complaint was the same as the one heard in the state action, except for the addition of federal claims, and thus the decision of the state courts barred the federal court from hearing the state claim portion of the complaint under the doctrine of *res judicata*.

Turning to the federal claim portion of plaintiff's complaint, the District Court held that these claims were also barred by the doctrine of *res judicata*. It relied on two Circuit Court of Appeals decisions, one which, on very similar facts, held that:

> [w]here the federal constitutional claim is based on the same asserted wrong as was the subject of a state action, and where the parties are the same, *res judicata* will bar the federal constitutional claim whether it was asserted in state court or not, for the reason that the state judgment on the merits serves not only to bar every claim that was raised in state court but also to preclude the assertion of every legal theory or ground for recovery that might have been raised in support of the granting of the desired relief.

Scoggin v. Schrunk, 522 F.2d 436, 437 (9th Cir. 1975).

Plaintiff appealed the District Court's ruling to the Third Circuit of Appeals. That court affirmed without opinion [and the United States Supreme Court denied certiorari].

Accord, Chattin v. Cape May Greene, Inc., 216 N.J. Super. 618 (App. Div. 1987). Thus, the federal case having been terminated in defendant's favor, the plaintiffs are barred by *res judicata* from asserting the *Mullane* constitutional theory in this Court.

APPENDIX J

EXCERPTS FROM BANK'S APPELLATE DIVISION BRIEF

[pp. 14-16]

The Stipulated Facts in this case contain, as Exhibit A, a copy of Judge Sarokin's decision granting First Fidelity summary judgment in *Ellovich v. North Jersey District Water Supply Commission and First Fidelity Bank, N.A., New Jersey*, Civ. Action No. 87-650 (HLS) (Pa. 61). That action was brought on behalf of the same class of plaintiffs as in the case at bar, albeit they were there represented by a different named plaintiff. Ellovich and Rudbart were duly certified as class actions by the respective courts. Compare Pa. 63 with Pa. 54-55. The two defendants in the two actions are identical.

In these circumstances it is well established that facts determined in the Ellovich action cannot be relitigated under the doctrine of collateral estoppel and claims are barred from relitigation by *res judicata*. *Supreme Tribe of Ben Hur v. Cauble*, 255 U.S. 356, 65 L. Ed. 673 (1921).

These principles have been followed by the courts of New Jersey in similar circumstances. In *Gregory Marketing v. Wakefern Food Corp.*, 207 N.J. Super. 607 (Law Div. 1985) plaintiffs had sued in federal court under the federal and state antitrust laws. The federal court dismissed the federal claims with prejudice, and the state claims without prejudice. 207 N.J. Super. at 613. Plaintiffs then brought a two count complaint in state court, asserting the claims that had been dismissed without prejudice.

In a thoughtful opinion the Law Division granted summary judgment dismissing the first count of the complaint. The court held that both the doctrines of *res judicata*, 207 N.J. Super. at 618-620, and collateral estoppel, 207 N.J. Super. at 620-624, barred the first count. Neither the pendency of an appeal,* 207 N.J. Super. at 621, 624, nor the dismissal of the state claims "without prejudice", 207 N.J. Super. at 613, was a bar to the Law Division holding that the federal claims adjudicated had preclusive effect on parallel state claims.

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> > (In Moitie), having elected to 'pitch' their pleadings under the federal statute, and having suffered summary judgment . . . appellants' antitrust claims became subject to a bar by judgment which was an extensive as those claims could be deemed to be well pleaded. Analytically, therefore, the judgment bar extended to the issues framed, not to the statutory labels invoked.
> >
> > * * *
> >
> > The federal judgment has extinguished the substance of appellants' antitrust claims,

---

*As was true when this case was heard below, but is no longer.

finally and conclusively. [Id. at 1433; emphasis added].

See also *Woods Exploration & Producing Co. v. Aluminum Company of America*, 438 F.2d 1286, 1312-23, 1315 (5th Cir. 1971) (*res judicata* precludes litigation of state antitrust claim in state court based on judgment rendered in federal court on federal antitrust claim if state and federal claims involve "substantially the same wrongs measured by similar standards of liability").

The principal issue in the *Ellovich* case was whether the official statement adequately disclosed to the plaintiff class that the sole notice of redemption would be by publication. The federal district and appeals courts conclusively, preclusively and correctly ruled it was. Pa. 61, 68; Da. 3.

* * *

[pp. 24-27]

B. The Mullane Claim Is Barred By Res Judicata.

The prior litigation in federal court involving identical parties arising from the same redemption bars the *Mullane* claim.

There is indisputably jurisdiction in federal court over constitutional claims. *See* 28 U.S.C. § 1331 ("The district courts shall have original jurisdiction of all civil actions arising under the Constitution . . . of the United States"); *Bivens v. Six Unknown Named Agents*, 403 U.S. 388 (1971). Thus, the *Mullane* claim might have been asserted in federal court.

Claims that might have been asserted in a prior case are barred by *res judicata*. In *Newark v. North Jersey Dist. Water Sup. Comm.*, 106 N.J. Super. 88, 99 (Ch. Div. 1968) the court held:

> It also follows that since the facts herein alleged in support of Newark's complaint to rescind the two water supply contracts could have been asserted to defeat the Commission's claim in the prior suit in which it sought an adjudication respecting the binding effect of the two contracts, the first suit is *res judicata* of the issues raised here. The judgment of a court of competent jurisdiction on a question of law or fact or on a mixed question of law or fact, once litigated and determined, is, so long as it stands unreversed, conclusive upon the parties and their privies. *Reeves v. Jersey City*, 30 N.J. Super. 392 (App. Div. 1954), *affirmed* 16 N.J. 529 (1954); *Hudson Transit Corp. v. Antonucci*, 137 N.J.L. 704 (E. & A. 1948); *Bango v. Ward*, 12 N.J. 415 (1953). The court in *Reeves, supra*, also stated:
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Indeed the case at bar is the mirror image of *Atkinson v. Pittsgrove Tp.*, 193 N.J. Super. 23 (Ch. Div. 1983), where the court noted approvingly that a federal court had dismissed a prior suit brought by Atkinson in federal court on the ground that even earlier Atkinson had brought a suit in state court (at 193 N.J. Super. 28):

> [The district court] concluded that the pending complaint was the same as the one heard in the state action, except for the addition of federal claims, and thus the decision of the state courts barred the federal court from hearing the state claim portion of the complaint under the doctrine of *res judicata*.
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> Turning to the federal claim portion of plaintiff's complaint, the District Court held that these claims were also barred by the doctrine of *res judicata*. It relied on two Circuit Court of Appeals decisions, one which, on very similar facts, held that:
>
> > [w]here the federal constitutional claim is based on the same asserted wrong as was the subject of a state action, and where the parties are the same, *res judicata* will bar the federal constitutional claim whether it was asserted in state court or not, for the reason that the state judgment on the merits serves not only to bar every claim that was raised in state court but also to preclude the assertion of every legal theory or ground for recovery that might have been raised in support of the granting of the desired relief.
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> *Scoggin v. Schrunk*, 522 F.2d 436, 437 (9th Cir. 1975).

> Plaintiff appealed the District Court's ruling to the Third Circuit of Appeals. That court affirmed without opinion [and the United States Supreme Court denied certiorari].

Accord, Chattin v. Cape May Greene, Inc., 216 N.J. Super. 618 (App. Div. 1987). Thus, the federal case having been terminated in defendant's favor, the plaintiffs are barred by *res judicata* from asserting the *Mullane* constitutional theory in the courts of this State.

APPENDIX K

EXCERPT FROM PETITION FOR CERTIFICATION TO NEW JERSEY SUPREME COURT

The Appellate Division decision is also inconsistent with the prior federal case, *Ellovich v. North Jersey Water District Supply Commission, et ano.* (D. N.J. Civ. Act. No. 87-650 (HLS)). The Appellate Division's opinion mischaracterizes First Fidelity's argument. We do not contend that Ellovich is *res judicata* as the Appellate Division suggests. But *Ellovich* has collateral estoppel effects. *See, Supreme Tribe of Ben Hur v. Cauble*, 255 U.S. 356 (1921).

The Appellate Division ignored collateral estoppel and assumed facts inconsistent with those found in *Ellovich*. At pages 10 and 11, the Appellate Division says:

> Initially, we note that the Commission never directly advised the purchasers of the notes that the only notice that they would receive of an early redemption would be through published notice in the newspaper. . . . However, neither document explicitly warned purchasers that newspaper notice would be the *only* notice they would receive". (Emphasis added).

If this were so, unquestionably a material fact was omitted from the public offering statements. This would have barred the federal grant of summary judgment, necessarily finding all required disclosures were made. The Appellate Division's decision assumes facts exactly contrary to those found in federal court, in violation of principles of collateral estoppel and the Supremacy Clause.

APPENDIX L

EXCERPT FROM SUPPLEMENTAL LETTER BRIEF OF JANUARY 30, 1992 IN NEW JERSEY SUPREME COURT

However, this Court should not reach the merits of this claim. It is barred by *res judicata*.

First Fidelity Bank, *National Association*, New Jersey, is a national banking association created pursuant to the National Bank Act, 12 U.S.C. § 21 *et seq*. When it acts as a trustee, it does so under a grant of fiduciary powers by the Comptroller of the Currency, pursuant to the National Bank Act, 12 U.S.C. § 92a(a).

The Comptroller of the Currency has adopted 12 C.F.R. § 9.10 entitled "Funds awaiting investment or distribution" in furtherance of the National Bank Act. This section, by its express terms, governs the duties and responsibilities of a national bank acting as trustee holding unredeemed note funds awaiting distribution.

Thus, because plaintiffs' claim concerns a national bank's duty, it arises under federal law. It is therefore within the jurisdiction of the federal courts. *See, e.g., First Nat'l Bank in Plant City, Florida v. Dickinson*, 396 U.S. 122 (1969); *Ramapo Bank v. Camp*, 425 F.2d 333, 345 n.33 (3d Cir.) *cert. denied*, 400 U.S. 828 (1970); *Suburban Trust Co. v. National Bank of Westfield*, 211 F. Supp. 694 (D.N.J. 1962)[2];

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[2] Even though the sections of the National Bank Act at issue in the cited cases (and here) make some reference to state law, the cases note that because it is a federal statute that invokes the state law, the question is federal for jurisdictional purposes.

cf. Busby v. Worthen Bank & Trust Co., N.A., 484 F. Supp. 647 (E.D. Ark. 1979) (applying federal law in diversity case).

There was a prior litigation arising from the Note redemption in the case at bar brought by the same class in federal court, *Ellovich v. North Jersey Water District Supply Commission, et ano.* (D.N.J. Civ. Act. No. 87-650 (HLS) (Pa. 60)). Class actions have the same claim and issue preclusion effects (*res judicata* and collateral estoppel) as ordinary suits. *Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356 (1921).

Just last term this Court dealt with the preclusive effect of a prior federal case on a subsequent state action. *Watkins v. Resorts Int'l. Hotel & Casino*, 124 N.J. 398 (1991). This Court held (at 412-413):

> Claim preclusion applies not only to matters actually determined in an earlier action, but to all relevant matters that could have been so determined. *Angel v. Bullington*, 330 U.S. 183, 192-93, 67 S. Ct. 657, 662, 91 L. Ed. 832, 838-39 (1947); *Culver v. Insurance Co. of N. Am.*, 115 N.J. 451, 463, 559 A.2d 400 (1989). For the purposes of *res judicata*, causes of action are deemed part of a single "claim" if they arise out of the same transaction or occurrence. *Restatement (Second) of Judgments*, supra, § 24. If, under various theories, a litigant seeks to remedy a single wrong, then that litigant should present all theories in the first action. Otherwise, theories not raised will be precluded in a later action. *Angel*, supra, 330 U.S. at 192-93, 67 S. Ct. at 662, 91 L. Ed. at 838-39; *Cemer v. Marathon Oil Co.*, 583 F.2d 830, 832 (6th Cir. 1978).

Here the bond redemption challenged in *Ellovich* was the identical "transaction" now at issue. There is federal jurisdiction over plaintiffs' theory of a national bank's duty with respect to funds awaiting distribution, as shown above. Thus, this theory, not raised in the first action, is precluded.[3]

If the Court were to reach the merits here, contrary to the above, it should still affirm the law division's grant of summary judgment to First Fidelity.

Plaintiff points to no evidence in the record that First Fidelity did not comply with 12 C.F.R. § 9.10. Plaintiff adduced no evidence, after an extensive period of discovery, that First Fidelity failed to adopt the policy required by § 9.10 or that it failed to comply with a policy it adopted. Absent such evidence, plaintiff has raised no genuine issue about First Fidelity's compliance with its duty arising from funds awaiting distribution.[4]

We here add only one point with respect to the applicability of N.J.S.A. 17:9A-35(D) if state law governs. The Appellate Division, in *dicta*, concluded it was inapplicable because it was adopted after the conduct in this case, 238 N.J. Super. at 51. But it was effective before any of the decisions in this case. The law is well established that absent extraordinary circumstances, a court applies the statutes in effect at the time of decision. *See, e.g., State,*

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[3] We do not contend that the federal court's jurisdiction was exclusive of the state courts to hear this claim originally. But once having litigated in federal court, the class must have all of its federal claims adjudicated there or they are barred.

[4] The portion of § 9.10 invoking local law is meant to preserve local limits on acceptable types of investment.

Dept. of Environ. Protect. v. Ventron Corp., 94 N.J. 473, 497-98 (1983); *Kruvant v. Mayor & Council Tp. of Cedar Grove*, 82 N.J. 435, 440-42 (1980). Here there are no extraordinary circumstances and the Appellate Division should have followed this "principle . . . to effectuate the current policy declared by the legislative body – a policy which is presumably in the public interest".[5]

With respect to the letter of counsel for the Commission, we agree with its conclusion that the record is devoid of any basis to compute damages (Pa. 54; stipulation as to liability only). We do note two small corrections, however.

First, it is undisputed that First Fidelity complied fully with the governing documents for these Notes, which were adopted by the Commission. There is neither evidence in the record nor an adjudication of the degree to which the Commission's *adoption* of the procedures here may give rise to its liability.

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[5] Moreover, the statute, like the Comptroller's regulation, contains a series of procedural rules (protecting the intent of the settlor, allowing trustees to recoup reasonable administrative fees, etc.) that are ill suited to judicial resolution. This is another reason for applying the legislative scheme instead of attempting to devise a common law approach. *See* 5 J. Bentham, *Works* 231 (1843) (comparing common law to dog training).

APPENDIX M

EXCERPT FROM LETTER OF MAY 13, 1991 TRANSMITTING REQUESTED SUPPLEMENTAL INFORMATION TO NEW JERSEY SUPREME COURT

Finally, if the Court decides to review this material, to the extent that it raises matters on which the Supreme Court does not have benefit of the analysis of either the trial court or the Appellate Division below, or of the parties either in briefs or oral argument, it is well to remember this Court's decision in *Ford v. Reichert*, 23 N.J. 429, 435 (1957):

> In the procedure before us, however, the judicial fundamental of the right to be heard seems to have been completely forgotten. This elementary privilege is seldom trespassed upon, but here neither party had the opportunity of presenting its views before they found themselves bound by the court's edict. If and when the Appellate Division concludes substantial justice requires the invoking of the plain error rule and the issues have not been presented or argued, the litigants are entitled to notice of the points the court thinks constitute plain error and have a right to be heard before a final determination. The court should not deprive the parties of their day in court or their right to be heard on matters which may defeat their cause.

APPENDIX N

EXCERPT FROM SUPPLEMENTAL LETTER OF SEPTEMBER 9, 1988 TO THE TRIAL COURT

September 9, 1988

VIA FEDERAL EXPRESS

Honorable Joseph L. Conn
Superior Court of New Jersey
Passaic County Court House
Paterson, New Jersey 07505

Re: Rudbart, et al. v. North Jersey
District Water Supply Commission, et al.
Docket No. L-025715-87

Dear Judge Conn:

I write pursuant to Your Honor's direction at the oral argument of the cross motions for summary judgment on September 2, 1988. By this letter brief we supplement the record on plaintiffs' claim in their complaint, not urged on this motion, that the conduct of the Bank's investment division in telephoning its customers constituted a breach of fiduciary responsibility.

Turning first to the factual environment, I enclose with this letter excerpts from the deposition of Alex Williams, Executive Vice President in charge of the investment division of the Bank; C. Edward Hoos, Senior Vice President in charge of the Bank's corporate trust operations in the trust department, and John C. Leeds, formerly the Executive Vice President of the trust department to whom Mr.

Hoos reported. These deposition transcripts establish several reasons why the Bank's conduct was not in derogation of its fiduciary obligations.

First, there was no communication between the Bank's trust operation and its investment division in connection with the redemption of the Notes. (Williams' Tr. 45, L. 23 – Tr. 46, L. 4; Tr. 59, L. 21 – Tr. 60, L. 13; Hoos' Tr. 124, L. 21 – Tr. 125, L. 2; Leeds' Tr. 36, L. 4 – Tr. 37, L. 3). The people to whom the investment division gave personal notice were known to it because they were its customers who had purchased the Notes from it. (Williams' Tr. 43, L. 11-24; Tr. 44, L. 6-12; Hoos' Tr. 125, L. 15-21; Leeds' Tr. 37, L. 4-20). Similarly, the investment division knew about the call not from the trust department but because the investment division itself had underwritten a new issue, the proceeds of which had been set aside to pay off the Notes involved in this litigation. (Williams' Tr. 44, L. 19-22).

There is nothing in the record to indicate that the personal notifications given by the investment division were in any way a result of the Bank's position as trustee. Rather, all of the evidence in the depositions is that the investment division routinely telephones its customers with respect to any major development in connection with securities it sold them. (Williams' Tr. 44, L. 6-12; Tr. 45, L. 3-12; Tr. 47, L. 24 – Tr. 48, L. 11).

The bulk of Mr. Williams' deposition was taken by the federal class action plaintiffs' lawyer. Mr. DeLuca, on behalf of the plaintiffs in the state action, engaged in a

brief summary cross-examination. A portion of that summary cross-examination goes exactly to the Court's interest (Williams' Tr. 58, L. 7 – Tr. 60, L. 13) and so we set it forth (omitting colloquy) for the Court here:

Q. I'd just like to ask you questions about the business practice of contacting customers of the investment department. Again, rather than rehashing I'm trying to shortcut some of it.

You indicated that it was good business to contact those customers. Is that correct?

A. Yes.

* * *

Q. Now, was an additional reason beyond those two that you already mentioned the fact that perhaps some of the bank's customers might have missed the call?

A. I couldn't be sure whether they had all seen the call.

Q. And was that because the call was by publication as opposed to by mail?

A. No. It was a customary procedure we followed regardless of how the call – the customers were notified of the call. We just called.

Q. So you would have contacted them, am I correct, whether or not the call had been made either by publication or by written notice through the mail. Is that your testimony?

A. Yes.

Q. You were also trying to develop new business at that point. Is that correct?

A. Yes.

Q. Okay. Did you have access to the records of the bank as it related to the people who had registered bonds with respect to this particular offering?

A. You mean other than the people with whom we [the investment division] had dealt?

Q. Yes.

A. No.

Q. Could you have gotten that information?

A. I'm sure we didn't ask for it. If we had asked for it I don't think the corporate trust department would have given it to us.

Q. Why, sir?

A. Well, I think they would have said it would have been a conflict of interest on their part. I don't know what they would have said because we didn't ask for it.

This testimony demonstrates unequivocably that the "Chinese Wall" between the trust department and the investment division was honored in this transaction. This redemption was treated by the investment division as it would treat any other material event with respect to any security it had sold its customers regardless of whether the Bank also acted as trustee, underwriter or in any other capacity. To hold such conduct is a breach of fiduciary responsibility would be to put the investment division's customers at a disadvantage due to the happenstance that the Bank's trust department had acted as trustee for a particular issue.

* * *

APPENDIX O

EXCERPT FROM BANK'S REPLY BRIEF SEEKING CERTIFICATION

Third, under the National Bank Act and the federal securities laws, the Bank must erect a "Chinese wall" between the trust and underwriting departments. *See, e.g., Washington Steel Corp. v. TW Corp.*, 602 F.2d 594 (3rd Cir. 1979); *Batsakis v. F.D.I.C.*, 670 F. Supp. 749 (W.D.Mi. 1987); Herzel & Collins, *The Chinese Wall & Conflict of Interest in Banks*, 34 Bus. Lawyer 73 (1978); Herman & Safanda, *The Commercial Trust Dept. and the "Wall"*, 14 B.C. Ind. & Comm. L. Res. 21 (1972).

Fourth, Judge Conn explicitly found the Chinese wall not breached here. (Letter Op. of 9/14/88 at 2) (Appended to petition for certification.)

CONCLUSION

For the foregoing reasons as well as those set out in our petition, this Court should grant certification and reverse the Appellate Division.

Respectfully submitted,

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BY: /s/
Michael A. Lampert

Newark, New Jersey
April 12, 1990